TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1924.

No. 413

GULF, MOBILE & NORTHERN RAILROAD COMPANY, PETITIONER,

vs.

[illegible]

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934.

No. 413

GULF, MOBILE & NORTHERN RAILROAD COMPANY, PETITIONER,

vs.

GUY T. HELVERING, AS COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., NOVEMBER 7, 1934.

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BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 42150

GULF, MOBILE & NORTHERN RAILROAD CO.

vs.

COMMISSIONER OF INTERNAL REVENUE

For Taxpayer: Geo. E. H. Goodner, Esq.
For Commissioner: E. C. Algire, Esq.

DOCKET ENTRIES

1928

Dec. 31. Petition received and filed. Taxpayer notified. (Fee paid.)

1929

Jan. 2. Copy of petition served on General Counsel.

Mar. 2. Answer filed by G. C.

" 16. Copy of answer served on taxpayer, assigned general calendar.

Oct. 28. Motion to place on circuit cal. at Mobile, Ala. filed by taxpayer.

" 31. Motion granted.

1930

Feb. 1. Hearing set Mar. 10, 1930 at Mobile, Ala.

" 26. Hearing set 3-31-30 at Mobile, Ala. (Revised notice.)

Apr. 4. Hearing had before Chas. M. Trammell, Div. 2, on merits. Amended petition filed; copy served on respondent; answer read into record; dockets 24887-35898-38295-42149 consolidated for hearing and decision. Briefs due 60 days from date.

" 16. Transcript of hearing at Mobile Ala. 4-2-30 filed.

June 13. Motion for 30 days extension to file brief, filed by taxpayer. 6-17-30 Granted.

" 30. Brief filed by G. C.

July 26. Motion to correct the record filed by taxpayer. 7-31-30 Granted.

1930

July 29. Motion for extension of 30 days to file brief, filed by taxpayer. 7-30-30 Granted.

Aug. 26. Brief filed by taxpayer.

[fol. 6]

1931

Feb. 20. Findings of fact and opinion rendered, Chas. M. Trammell; judgment will be entered under Rule 50.

May 15. Motion to correct findings and opinion filed by taxpayer.

" 15. Proposed settlement under Rule 50 filed by taxpayer.

" 21. Hearing set May 28, 1931 on settlement.

" 21. Hearing set May 28, 1931 on motion.

" 26. Order that proceedings be stricken from day calendar of 5-28-31 and continued sine die, entered.

" 22. Copy of motion and notice of hearing date served on G. C.

July 8. Hearing set Aug. 5, 1931 on motion.

" 6. Motion for Board to correct its opinion of Feb. 20, 1931 filed by G. C.

" 6. Notice of settlement filed by G. C.

" 8. Hearing set Aug. 5, 1931 on settlement.

Aug. 5. Hearing had before Chas. P. Smith, Div. 5, on motion to correct opinion; by consent continued to Sept. 9, 1931.

" 5. Order continuing hearing to Sept. 9, 1931.

" 18. Motion for continuance to Sept. 23, 1931, filed by G. C. 8-19-31 Granted.

Sept. 23. Hearing had before Mr. Trammell on respondent's motion to correct opinion. Notice of settlement filed.

Sept. 30. Order modifying and amending opinion, entered.

" 30. Decision entered, C. M. Trammell, Div. 2.

" 28. Transcript of hearing of 9-23-31 filed.

Nov. 2. Motion to vacate and set aside decision and to substitute attached decision, filed by taxpayer.

" 7. Revised decision entered—C. M. Trammell, Div. 2.

Dec. 4. Motion to set aside decision of Nov. 7, 1931 and to reconsider decision of Feb. 20, 1931, filed by G. C.

1931.

Dec. 9. Hearing set Dec. 16, 1932 on motion.
" 16. Hearing had before Mr. Trammell on respondent's motion to set aside decision. Taken under advisement.

[fols. 7-29]

Dec. 19. Order that respondent's motion to set aside final decision of 11-7-31 and reconsider decision promulgated 2-20-31 be granted and that decision of Board entered 11-7-31 be modified entered.
" 21. Order that petitioner's objection and exception to order of Dec. 19, 1931 be made a matter of record, entered.

1932

Jan. 25. Motion for settlement without prejudice & agreed to by G. C., filed by taxpayer.
" 25. Order that revised decision entered Nov. 7, 1931 be vacated and set aside and second revised decision entered, C. M. Trammell, Div. 2.
Mar. 22. Transcript of hearing Dec. 16, 1932 filed.
July 25. Stipulation to have case reviewed by Court of Ap. of D. C. filed.
" 25. Petition for review to Ct. of Appeals of D. C. with assignments of error filed by taxpayer.
" 25. Proof of service filed.
Sept. 19. Motion for extension to 10-23-32 to prepare and transmit record filed by taxpayer.
" 19. Order enlarging time to 10-23-32 to prepare and transmit record entered.
Oct. 18. Præcipe with proof of service thereon filed.
" 18. Agreed statement of evidence lodged.
" 20. Agreed statement of evidence approved and filed.
" 21. Order enlarging time to Nov. 30, 1932 *6*o transmit and deliver record entered.

[fol. 30] [File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 42150

[Title omitted]

PETITION—Filed Dec. 31, 1928

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols IT:AR:RR-60D—JSM), dated November 6, 1928, and as the basis of its proceeding alleges as follows:

1. The petitioner is a corporation with principal office at 71 Conti Street, Mobile, Ala.

2. The notice of deficiency, a copy of which is attached hereto and marked Exhibit "A" was mailed to petitioner on November 6, 1928.

[fol. 31] 3. The taxes in controversy are income taxes as follows:

Year 1924	$9,690.95
" 1925	15,391.97
" 1926	1,973.31
Total	$27,056.23

4. The determination of tax, as set forth in the said notice of deficiency, is based upon the following errors:

(a) In computing taxable net income for the year 1924 the Commissioner has erroneously disallowed as a deduction listing fees on capital stock in the amount of $2,400.00.

(b) In computing taxable net income for the year 1924 the Commissioner has erroneously disallowed as a deduction expenditures in the amount of $3,283.85 on account of transportation for investment—Credit.

(c) In computing the taxable net income the Commissioner has erroneously disallowed amortization of bond

discount in the amount of $4,585.32 for each of the years 1924, 1925 and 1926.

(d) In computing taxable net income for the years 1925 and 1926 the Commissioner has erroneously included the estimated additional mail pay in the amounts of $4,280.29 and $10,200.58, respectively.

(e) In computing the taxable net income for the year 1926 the Commissioner has erroneously disallowed as a deduction depreciation on Ways and Structures of its subsidiary, the Jackson & Eastern Railway Company, in the amount of $7,374.87.

5. The facts upon which petitioner relies, as the basis of this proceeding, are as follows:

(a) Petitioner is a corporation, organized under the laws of the State of Alabama and other States, with principal office at 71 Conti Street, Mobile, Ala. Ever since organization it has been engaged in the operation of railroads.

(b) In each of the years 1924, 1925 and 1926 petitioner was affiliated with the Meridian & Memphis Railway Company and from August 15th to December 31st, 1926, petitioner was affiliated with the Jackson & Eastern Railway Company.

(c) Petitioner rendered a timely income tax return for the calendar year 1924 (including therein the results of the [fol. 32] operations of the Meridian & Memphis Railway Company) which showed a net income of $1,060,384.95 and a tax liability of $132,548.12. Petitioner rendered a timely income tax return for the calendar year 1925 (including therein the results of the operations of the Meridian & Memphis Railway Company) showing a net income of $1,355,-470.63 and a tax liability of $176,211.18.

Petitioner rendered a timely income tax return for the year 1926 (including therein the operating results of the Meridian & Memphis Railway Company for the entire year 1926 and the Jackson & Eastern Railway Company from August 15th to December 31, 1926) showing a consolidated net income of $1,408,738.06, and a tax liability of $190,-179.64.

(c) In the year 1924 petitioner expended $2,400.00 in connection with listing its stock on the New York Stock Exchange, which amount was deducted on its income tax return as an expense for that year. The Commissioner has disallowed the deduction, which gives rise to the error noted in paragraph 4 (a) above.

(d) During the year 1924 petitioner transported material and supplies, etc., of its own from one point to another over its own line, and for its own use.

Under the Interstate Commerce Commission rules a regular transportation charge must be entered in an account termed "Transportation for Investment-Credit."

The charge for the year 1924 amounted to $3,283.85. The Commissioner has excluded this item from deductible expenses in computing taxable net income, which action gives rise to the error noted in paragraph 4 (b) above.

(e) The Meridian & Memphis Railway Company, a subsidiary of the petitioner, issued and sold its First Mortgage Bonds in the year 1913, at a discount of $131,200.00.

This discount is being amortized over the life of the bonds, in accordance with the method prescribed by the Interstate Commerce Commission. The proportionate part applicable to and deducted in each of the years 1924, 1925 and 1926 was $4,585.32. This amount was deducted in each of the years in arriving at the consolidated net income.

The Commissioner has disallowed the deduction in each year, which action gives rise to the error noted in paragraph 4 (c) above.

(f) On July 10, 1928 the Interstate Commerce Commission entered Order No. 9200 "Railway Mail Pay" in which [fol. 33] common carriers subject to the Act of July 28, 1916 were granted certain retroactive increases in the rates theretofore established for transportation of the U. S. Mails.

The Commissioner has erroneously added the estimated additional mail pay granted under this order to the income for the year 1925, in the amount of $4,280.29 and in the year 1926 in the amount of $10,200.58. This action gives rise to the error noted in paragraph 4 (d) above.

(g) The Jackson & Eastern Railway Company, a subsidiary of the petitioner, charged off on its books deprecia-

tion on Ways and Structures, consisting of bridges, trestles, culverts, rails, roadway buildings, etc., for the period August 15th to December 31, 1926, aggregating $7,374.87.

The Commissioner has erroneously disallowed this deduction, which gives rise to the error noted in paragraph 4 (e) above.

6. Wherefore, petitioner prays that this Board may hear the proceeding and find:

(a) That listing fees in the amount of $2,400.00 were properly deductible in arriving at the net taxable income for the year 1924.

(b) That expenditures in the amount of $3,283.85 in transporting its own material over its own lines for its own use and charged as transportation for investment-credit, on its records, should be allowed as a deduction in computing the taxable net income for the year 1924.

(c) That bond discount on Meridian & Memphis Railway Company First Mortgage Bonds, in the amount of $4,585.32, should be allowed as a deduction in each of the years 1924, 1925 and 1926.

(d) That estimated additional mail pay in the amount of $4,280.29 and $10,200.58 was not taxable income for the years 1925 and 1926, respectively.

(e) That depreciation on Ways and Structures of the Jackson & Eastern Railway Company, in the amount of $7,374.87, should be allowed in computing the net income for the year 1926.

(f) That petitioner's tax liability for the years 1924, 1925 and 1926 should be recomputed on the basis of your find-
[fol. 34] ings and the deficiency or over-payment re-determined on such basis.

And grant such other relief as Petitioner may be entitled to or which to the Board may seem equitable and proper.

Geo. E. H. Goodner, Counsel for Petitioner. Address: Munsey Building, Washington, D. C. Of Counsel: Walter K. Smith, Mobile, Alabama.

Duly sworn to by R. E. De Neefe. Jurat omitted in printing.

EXHIBIT "A" TO PETITION

Treasury Department

Office of Commissioner of Internal Revenue

IT:AR:RR-60D. JSM.

Washington, D. C., Nov. 6, 1928.

Gulf, Mobile and Northern Railroad Company, 71 Conti Street, Mobile, Alabama.

SIRS: In accordance with Section 274 of the Revenue Act of 1926 you are advised that the determination of your tax [fol. 35] liability for the years 1924, 1925 and 1926, discloses a deficiency of 27,056.23, as shown in the attached statement.

The sections of the law above mentioned allows you to petition the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter for a redetermination of your tax liability. However, if you acquiesce in this determination, you are requested to execute the enclosed Form 866 and forward both original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully, D. H. Blair, Commissioner, (Signed) by C. B. Allen, Deputy Commissioner.

Enclosures: Statement, Form 866, Form 882, Schedules Nos. 1 to 9, inclusive.

IT:AR:RR—60D. JSM.

Statement of Returns Examined and Resulting Tax Liability

Returns Examined

Company	Year	Form
Gulf, Mobile and Northern Railroad Company, Mobile, Alabama	1924	1120
	1925	1120
	1926	1120

Resulting Tax Liability

Company	Year	Tax liability	Deficiency
Gulf, Mobile and Northern Railroad Company, Mobile, Alabama	1924	$142,239.07	$9,690.95
	1925	191,603.15	15,391.97
	1926	192,152.95	1,973.31
Totals		$525,995.17	$27,056.23

The adjustments producing the above-stated results are contained in the attached schedules 1 to 9, inclusive.

[fol. 36] In determining your tax liability as stated herein, careful consideration has been given to the statements contained in your protest dated June 12, 1928, and the additional information submitted at conference held in this office July 23, 1928.

A carbon of this letter has been mailed to each of your representatives, Mr. George E. H. Goodner, Munsey Building, Washington, D. C., and Mr. Walter K. Smith, City Bank Building, Mobile, Alabama, in accordance with your powers of attorney running to them, which are on file in this office.

Schedule 1

Net Income

Net income as disclosed by returns	$1,060,384.95
As corrected	1,137,912.56
Net adjustment	$77,527.61

Unallowable deductions and additional income:

(a) Contributions	$866.67
(b) Listing stock fees	2,400.00
(c) Transportation for investment credit	3,283.85
(e) Repairs	8,428.74
(f) Fines for violation Federal Laws	523.64
(g) Write-down investment in securities	5,677.00
(h) Federal income taxes	45.54
(i) Amortization of bond discount	2,106.72

(j) Meridian and Memphis Railway Company bond discount amortization	4,585.32
(k) Interest during construction, sale of Hattiesburg Branch	35,310.13
(l) Increase in personal injury reserve	14,300.00
Total	$77,527.61

Schedule No. 1-A

Explanation of Items Charged

(a) Contributions are unallowable deductions in accordance with the provisions of Office Decision No. 986, Cumu- [fol. 37] lative Bulletin No. 5, Page 222. Therefore, the following payments during the year 1924 are herein disallowed:

Y. M. C. A., Mobile, Alabama	$300.00
Y. M. C. A., Laurel, Mississippi	166.67
Y. M. C. A., Laurel, Mississippi	400.00
Total	$866.67

(b) This expenditure of $2,400.00 was for the purpose of listing your capital stock on the New York Exchange. In accordance with the provisions of I. T. 1836, C. B. 11-2, page 158, the fee paid by a corporation to a stock exchange for the purpose of listing its stock is considered a capital expenditure and is not deductible as a business expense.

(c) Transportation for investment, credit, $3,283.85.

It is held that amounts credited to Transportation for Investment, Credit, account are not within the purview of Office Decision 811, C. B. 4, page 276, such amounts representing the allocated cost of transporting men and materials in connection with construction work, which had been charged to operating expenses, are capital expenditures. (See also Great Northern Railway Company, 8 B. T. A. 225.)

(e) Amount charged to Suspense Account—General, during the months of July, August, October and November, 1923, for "Repairs" to the Gulf, Mobile and Northern Official Car No. 50, and cleared monthly from this account beginning in 1924, and charged to Maintenance of Equip-

ment—Account #326, for the reason that having determined that the cost of such repairs did not constitute the major portion of the value as renewed, therefore, the cost represents an operating expense.

This expense was cleared over a period of eleven months, commencing from October, 1924, to and including the month of August, 1925, at the rate of $2,809.57, per month and as the cost of repairing this car is applicable to the year 1923, the deduction taken in 1924 and 1925 is disallowed in accordance with Article 112, Regulations 65.

Prorated over period October 1 to December 31, 1924	$8,428.74
Prorated over period January 1 to December 31, 1925	22,476.56
Total	$30,905.30

[fol. 38] (f) Fines for violation of Federal Laws are not ordinary and necessary expenses of operation under Section 214 of the Revenue Act of 1924. Deduction of $523.64, is therefore disallowed (Great Northern Railway Company case, 8 B. T. A., page 225).

(g) Loss claimed on investments in stock and bonds is not deductible since the securities have not been proven worthless, or disposed of:

Mississippi Export Railroad Company stock	$2,434.00
Jackson and Eastern Railway Company bonds	3,243.00
Totals	$5,677.00

(h) Federal income taxes of $136,045.54 are included in your "Railway Tax Accruals" account. Since $136,000.00 has been treated as an unallowable deduction on your return, the difference, of $45.54, is now added back to taxable income.

(i) The amount of $2,106.72 is debt discount or expense extinguished through surplus applicable to prior years and, therefore, not deductible for the current year.

(j) The Meridian and Memphis Railway Company was affiliated with your corporation during the years 1924, 1925 and 1926 and included in the consolidated return. The

bonds were intercompany obligations, which fact is conceded by you. Under the decision of the Board of Tax Appeals in the case of the New Orleans, Texas and Mexico Railroad Company, 6 B. T. A., page 436, the Commissioner was sustained on a similar adjustment.

Amortization of discount on funded debt by the Meridian and Memphis Railroad Company in the amount of $4,585.32 is, therefore, disallowed as a deduction.

(k) It is noted that an estimated value was used in the determination of the loss on the sale during the year 1924 of the Hattiesburg branch. Since such estimated value included $35,310.13 as interest during construction, this amount is disallowed as a deduction.

(l) This amount is disallowed for the reason that it represents a reserve for anticipated losses resulting from personal injury. According to information submitted with your letter of July 26, 1928, the following net credits were made to the "Personal Injury Reserve" *ac* account during the years indicated:

[fol. 39]

Year	Account
1923	$47,200.00
1924	14,300.00
1925	88,500.00
1926	(5,190.00)

Schedule 2

Consolidated Reconciliation of Surplus

Surplus at beginning of year:	
Gulf, Mobile and Northern Railroad Company	$3,675,548.01
Meridian and Memphis Railway Company (deficit)	(363,828.87)
Consolidated surplus at beginning of year	$3,311,719.14
Net income as corrected, Schedule 1	1,137,912.56

Nontaxable Income:		
Donations		7,185.95
Interest during construction		1,890.24
Interest during construction (prior years)		18,913.66
Capital account charged with deep well		2,824.03
Obsolescence of Blodgett branch		44,794.45
Total		4,525,240.03
Amount brought forward		$4,525,240.03
Unallowable deductions:		
Contributions	$866.67	
Listing stock fees	2,400.00	
Repairs	8,428.74	
Fines for violation Federal Laws	523.64	
Write-down of investments	5,677.00	
Federal income taxes	136,045.54	
Amortization bond discount	2,106.72	
Dividends	713,000.00	
Meridian and Memphis Bond discount amortization	4,585.32	
Interest during construction on Hattiesburg branch	35,310.13	
[fol. 40] Increase in personal injury reserve	14,300.00	
Total, deduct from above		923,243.76
Balance, surplus at end of the taxable year		$3,601,996.27
Surplus at end of year 1924:		
Gulf, Mobile and Northern Railroad Company		$3,970,446.55
Meridian and Memphis Railway Company (deficit)		(368,450.28)
Consolidated surplus at the end of year		$3,601,996.27

Schedule 3

Computation of Taxes, 1924 Rates

Net Income	$1,137,912.56
Income tax at 12½%	142,239.07
Taxes previously assessed	132,548.12
Additional tax to be assessed	$9,690.95

Gulf, Mobile and Northern Railroad Company

Year Ended December 31, 1925

Schedule 4

Net Income

Net income as disclosed by return	$1,355,470.63
As corrected	1,473,870.42
Net adjustment	$118,399.79

[fol. 41] Unallowable deductions and additional income:

(a) Contributions	$1,600.00
(c) Loss on retired road	2,824.03
(d) Repairs	22,476.56
(e) Transportation for investment, Cr.	77.48
(f) Write-down in value of investments	2,751.00
(g) Meridian and Memphis Railway Company bond discount amortization	4,585.32
(h) Increase in personal injury reserves	88,500.00
(i) Additional mail pay	4,280.29
Total additions	$134,094.68
Nontaxable income and additional deductions:	
(j) Unamortized expense, Series "A" bonds	15,694.89
Net adjustment as above	$118,399.79

Schedule 4-A

Explanation of Items Changed

(a) Contributions are unallowable deductions. See Item (a), Schedule 1 (a).

Donations to Firemen	$100.00
Y. M. C. A. contributions	1,500.00
Total	1,600.00

(c) It is noted that you have included in the charge to profit and loss for loss on retired road an amount of $2,824.03, on account of the abandonment of a deep well at Louisville, Mississippi. Since the capitalization of this amount in 1924 was treated as non-taxable income, the deduction against gross income in 1925 is disallowed.

(d) See item (e), Schedule No. 1-A.

(e) See Item (c), Schedule No. 1-A.

(f) Miscellaneous debits, $9,751.00.

[fol. 42] The *right*-down in value of securities held by your company can not be considered an allowable deduction in view of the provisions of Article 144, Regulations 65:

Adjustments as follows are, therefore disallowed:

Write-down in value of Mississippi Export Railroad Company stock	$5,258.00
Write-down in value of Jackson and Eastern Railway Company bonds	4,493.00
Total	$9,751.00

(g) See item (j) Schedule 1-A.

(h) The amount set up in anticipation of personal injury claims as an unadjusted credit—Suspense Account General—$88,500.00, is added to taxable income for the reason that the deduction taken is not applicable to the year 1925 (Article 112, Regulations 65).

(i) On July 10, 1928, the Interstate Commerce Commission entered Order No. 9200, "Railway Mail Pay," in which common carriers subject to the Act of July 28, 1916, were granted certain retroactive increases in the rates theretofore established for transportation of the United States

Mails. In accordance with the reasoning adopted by the United States Board of Tax Appeals, in the case of the Western Maryland Railway Company, Docket No. 6475, with respect to the issue of railway mail pay, the amount of $4,280.29 representing the additional railway mail pay reported in your letter dated September 27, 1928, is included in your taxable income for the year 1925.

(j) Unamortized expense, Series "A" bonds, $12,042.38.

In accordance with the provisions of General Counsel Memorandum #3832, C. B. V11—22, page 3, on the subject of amortization of bond discount and expense, the expenses of Series "A" bonds should be amortized through the years 1920 to 1925, and any unamortized balance remaining when the bonds were prematurely retired would be deductible in the year of retirement. Accordingly, the following adjustment appears to be in order and has been made.

Expense sustained		$19,446.73
Date of issue: October 1, 1920.		
Date of maturity: October 1, 1950.		
[fol. 43] Chargeable:		
1920	$162.06	
1921	648.22	
1922	648.22	
1923	648.22	
1924	648.24	
		2,754.96
Balance allowable in 1925		$16,691.77
Amount deducted on return	$4,549.39	
Deductible, Series B bonds	3,552.51	
Difference, deduct from above		996.88
Additional deduction allowable		$15,694.89

Schedule 5

Consolidated Reconciliation of Surplus

Surplus at beginning of year:		
Gulf, Mobile and Northern Railroad Company		$3,970,446.55
Meridian and Memphis Railway Company (deficit)		368,450.28
Consolidated surplus at beginning of year		$3,601,996.27
Net income as corrected, Schedule # 4		1,473,870.42
Nontaxable income:		
Donations		8,640.42
Income on Government Securities		20,247.14
Interest during construction		13.17
Obsolescence of Blodgett branch		44,794.45
Unamortized expense, Series "A" bonds		15,694.89
Total		$5,175,256.76
Unallowable deductions:		
Additional mail pay	$4,280.29	
Contributions	1,600.00	
Dividends	998,788.50	
[fol. 44] Income taxes	174,000.00	
Loss on retired road	2,824.03	
Repairs	22,476.56	
Miscellaneous debits	9,751.00	
Meridian and Memphis bond discount	4,585.32	
Personal injury reserve increase	88,500.00	
Total deduct from above		1,306,805.70
Balance		$3,868,451.06

Surplus at end of year:	
Gulf, Mobile and Northern Railroad Company	4,241,486.66
Meridian and Memphis Railway Company (defict)	373,035.60
Consolidated surplus at end of year	$3,868,451.06

Schedule 6

Computation of Taxes, 1925 Rates

Net income taxable year, Schedule 4	$1,473,870.42
Income tax at 13%	191,603.15
Taxes previously assessed	176,211.18
Additional tax to be assessed	$15,391.97

Gulf, Mobile and Northern Railroad Company

Year Ended December 31, 1926

Schedule 7

Net Income

Net income as disclosed by return	$1,408,738.06
As corrected	1,423,355.17
Net adjustment	$14,617.11

[fol. 45] Unallowable deductions and additional income:

Gulf, Mobile and Northern R. R. Company:		
(a) Contributions	$750.00	
(c) Write-down value of securities	3,248.00	
(d) Amortization expense, Series "A" bonds	632.69	
(e) Excessive loss on sale reported	225.00	

(f) Additional mail pay	9,747.42	
Meridian and Memphis Railway Company:		
(g) Bond discount	4,585.32	
Jackson and Eastern Railway Company:		
(i) Federal income taxes	600.00	
(j) Depreciation on way and structures	7,374.87	
(k) Additional mail pay	453.16	
Total additions		27,616.46
Nontaxable income and additional deductions:		
Gulf, Mobile and Northern Railroad Company:		
(l) Adjustment value Jackson and Eastern bonds	7,736.00	
(m) Decrease in Personal Injury reserve	5,190.00	
(n) Amortization of bond discount	73.35	
Total deductions		12,999.35
Net adjustment as shown above		$14,617.11

Schedule 7-A

Explanation of Items Changed

(a) See Schedule 1-A, item (a).

[fol. 46] (c) Reduction in the book value of investment in securities is not deductible for the reason that the securities have not been proven worthless or disposed of. Article 144, Regulations 69.

(d) Amortization of expense, Series "A" bonds, $632.69.

Since the unamortized expenses on series "A" bonds has been allowed as a deduction from gross income in the year of retirement and cancellation (1925), the amount $632.69, taken as a deduction during the year 1926 is disallowed:

Deduction allowable B bonds	$5,482.03
Deduction taken on return	6,114.72
	$632.69

(e) Loss on sale of 77 acres of land at Ellisville, Mississippi, purchased at $8.00 per acre:

Cost	$616.00
Sale price (A. F. E. 1841)	225.00
Loss sustained	$391.00

Since a charge of $616.00 was included in your miscellaneous debits on account of the above transaction, the loss on sale reported in excess of the actual loss sustained is disallowed.

(f) On July 10, 1928, the Interstate Commerce Commission entered order No. 9200, "Railway Mail Pay," in which common carriers subject to the Act of July 28, 1916, were granted certain retroactive increases in the rates theretofore established for the transportation of the United States Mails. In accordance with the reasoning adopted by the United States Board of Tax Appeals, in the case of the Western Maryland Railway Company, Docket No. 6475, with respect to the issue of Railway Mail Pay, the amount $9,747.42 representing the additional Railway Mail Pay reported in your letter dated September 27, 1928, is included in your taxable income for the year 1926.

(g) See explanation under item (j), Schedule 1-A.

(i) See item (f) amount applicable to period August 16, to December 31, 1926.

(j) Federal income taxes are unallowable deductions in accordance with the provisions of Article 131, Regulations 69.

[fol. 47] (k) Depreciation on way and structures is held to be an unallowable deduction from gross income in accordance with Treasury Decision 3125. Since this point is on appeal by the Jackson and Eastern Railway Company for prior years, deduction thereof is disallowed.

(l) Write-up in books value of securities held by your corporation is non taxable income. Since the write-down in value during the years 1924 and 1925 was charged to

profit and loss as a miscellaneous debit and has been disallowed as a deduction in the audit of prior years, adjustment is now made for the amount restored in the valuation of Jackson and Eastern Railway Company's bonds held by your corporation.

(m) Inasmuch as the amount set up in anticipation of personal injury claims was disallowed in the audit of the year 1925, the charges to the suspense account of claims paid during the year 1926 are hereby allowed as deductions.

(n) In the spread of discount and expenses of $750.00 sustained in connection with the issue of $30,000.00 obligations of the Jackson and Eastern Railway Company, the amount of $73.35 is an allowable reduction for the period August 16, to December 31, 1926:

Period	Amortization allowable
March 20, 1926 to August 15, 1926	$73.35
August 16, 1926 to December 31, 1926	73.35
Year 1927	195.65
1928	195.65
1929	195.65
1930	16.35
total	$750.00

[fol. 48]

Schedule 8

Consolidated Reconciliation of Surplus

Surplus at beginning of year:	
Gulf, Mobile and Northern Railroad Company	$4,241,486.66
Meridian and Memphis Railway Company (deficit)	(373,035.60)
Jackson and Eastern Railway Company, August 15, 1926	62,271.15
Consolidated surplus at beginning of year	$3,930,722.21
Net income as corrected, Schedule 7	$1,423,355.17

Nontaxable income:		
Donations		$20,288.03
Income from Government Securities		37,572.22
Interest during construction		2,191.25
Jackson and Eastern Railway Company amortization of bond discount		73.35
Personal injury reserve reduction		5,190.00
Book value adjustment of investment in securities		7,736.00
Obsolescence of Blodgett branch		44,794.45
Total		$5,471,922.68
Unallowable deductions:		
Contributions	$750.00	
Write-down book value of stock	3,248.00	
Loss on sale reported, excessive	225.00	
M. and M. bond discount, intercompany	4,585.32	
Federal income taxes	193,687.63	
Jackson and Eastern income taxes	600.00	
Dividends	970,260.00	
Depreciation of Way and Structures	7,374.87	
[fol. 49] Amortization expense, Series "A"	632.69	
Additional mail pay	10,200.58	
Total, deduct from above		1,191,514.09
Balance, surplus at end of year		$4,280,358.59
Surplus at end of taxable year 1926:		
Gulf, Mobile and Northern Railroad Company		4,598,683.91
Meridian and Memphis Railway Company (deficit)		(373,080.66)
Jackson and Eastern Railway Company		54,755.34
Total as above		$4,280,358.59

Schedule 9

Computation of Taxes, 1926 Rates

Net income taxable year, Schedule 7	$1,423,355.17
Income tax at 13½%	192,152.95
Taxes previously assessed, Account #40658	190,179.64
Additional tax to be assessed	$1,973.31

[File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 42150

[Title omitted]

ANSWER—Filed March 2, 1929

Comes now the Commissioner of Internal Revenue, by his attorney C. M. Charest, General Counsel, Bureau of [fol. 50] Internal Revenue, and for answer to the petition filed herein, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. (a) to (e), incl. Denies that the respondent erred as alleged in subparagraphs (a) to (e), inclusive, of paragraph 4 of the petition.

5. (a) to (g), incl. Denies the allegations contained in subparagraphs (a) to (g), inclusive, of paragraph 5 of the petition.

Denies each and every other allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore it is prayed that the Commissioner's determination be approved and that the petition be dismissed and the appeal denied.

(Signed) C. M. Charest, General Counsel, Bureau of Internal Revenue. Of Counsel: A. H. Fast, Special Attorney, Bureau of Internal Revenue.

A true copy. Teste:
B. D. Gamble, Clerk U. S. Board of Tax Appeals.

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22 B. T. A., —

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 24887, 35898, 38295, 42149, 42150

GULF, MOBILE & NORTHERN RAILROAD COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

[fols. 51 & 52] JACKSON & EASTERN RAILWAY COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

MERIDIAN & MEMPHIS RAILWAY COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

FINDINGS OF FACT AND OPINION—Promulgated February 20, 1931

George E. H. Goodner, Esq., and Walter K. Smith, Esq., for the petitioners.

E. C. Algire, Esq., for the respondent.

These proceedings have been consolidated for hearing and decision. The respondent has determined deficiencies in income taxes, for the years and in the amounts, as follows:

Petitioner	Docket No.	Year	Deficiency
Gulf, Mobile & Northern Railroad Co.....	24887	1920	$14,731.74
Gulf, Mobile & Northern Railroad Co.....	42150	1924	9,690.95
		1925	15,391.97
		1926	1,973.31
Jackson & Eastern Railway Company.....	38295	1923	2,145.55
		1924	1,275.53
		1925	4,030.04
Jackson & Eastern Railway Company.....	42149	1926	1,838.02
Meridian & Memphis Railway Company....	35898	1922	2,603.29

[fol. 53]

Docket No. 42150

The petitioner, Gulf, Mobile & Northern, makes six assignments of error, one of which is admitted by the respondent, leaving the following for decision by the Board:

(a) In computing taxable net income for the year 1924 the Commissioner has erroneously disallowed as a deduction listing fees on capital stock in the amount of $2,400.

(b) In computing taxable net income for the year 1924 the Commissioner has erroneously disallowed as a deduction expenditures in the amount of $3,283.85 on account of transportation for investment—Credit.

(c) In computing the taxable net income the Commissioner has erroneously disallowed amortization of bond discount in the amount of $4,585.32 for each of the years 1924, 1925 and 1926.

(e) In computing the taxable net income for the year 1926 the Commissioner has erroneously disallowed as a [fols. 54 & 55] deduction depreciation on ways and structures of its subsidiary, the Jackson & Eastern Railway Company, in the amount of $7,374.87.

(f) In computing taxable net income for the years 1924, 1925 and 1926 the Commissioner has erroneously disallowed as deductions amounts paid to Young Men's Christian Associations located at division points on petitioner's railway system in the amounts of $866.67, $1,500 and $750 for the respective years aforesaid.

The one assignment of error admitted by the respondent is as follows:

(d) In computing taxable net income for the years 1925 and 1926 the Commissioner has erroneously included the estimated additional mail pay in the amounts of $4,280.29 and $10,200.58 respectively.

[fols. 56-60] Findings of Fact

The petitioner, Gulf, Mobile & Northern, is an Alabama corporation with its principal office at 71 Conti Street, Mobile, Alabama.

The petitioner, Jackson & Eastern, is a Mississippi corporation with its principal office at 71 Conti Street, Mobile, Alabama. All of the capital stock of this company was acquired by the Gulf, Mobile & Northern, on August 15, 1926.

The petitioner, Meridian & Memphis, is a Mississippi corporation with its principal office at 71 Conti Street, Mobile, Alabama. It is a subsidiary of the Gulf, Mobile & Northern.

The Gulf, Mobile & Northern and the Meridian & Memphis filed consolidated returns for 1920, 1921, 1922, 1924 and 1926. A single consolidated return was filed by these three petitioners, for 1926, in which there was included the income of the Jackson & Eastern for the period August 16 to December 31, 1926.

[fols. 61–65] Amortization of Bond Discount

Issue (c), Docket 42150

At various dates between 1913 and 1916, the Meridian & Memphis sold its 30-year 5 per cent gold bonds, of a total face value of $675,000, to the Equitable Loan & Mortgage Company of Mobile, at a discount of approximately $131,000. At the time the Gulf, Mobile & Northern acquired the capital stock of the Meridian & Memphis, the bonds of the latter were pledged as collateral for certain collateral trust notes of the Equitable Loan & Mortgage Company. These notes fell due during the period of federal control and were taken up by the War Finance Corporation. At the end of federal control the Gulf, Mobile & Northern settled with the War Finance Corporation for the notes, and took over the bonds pledged as collateral thereto, at a cost of $636,000. Each year, the Meridian & Memphis has charged off on its books 1/30th of the discount on its bonds, and in its returns for 1924, 1925 and 1926, claimed deductions for amortization of bond discount, each in the amount of $4,585.32. These deductions have been disallowed by the respondent in determining consolidated net income.

[fols. 66-87] OPINION.

TRAMMELL:

[fols. 88-95] Amortization of Bond Discount

Issue (c), Docket 42150

The question whether a corporate taxpayer, having issued its bonds for a price less than their aggregate face value, may deduct a pro rata part of the discount, in computing consolidated net income for a year in which such bonds were owned by its affiliated company, has been decided by the Board, in New Orleans, Texas & Mexico Railway Company, 6 B. T. A. 436, adversely to the petitioner; and upon authority of that decision, we hold that the respondent, in computing the consolidated net income for 1924, 1925 and 1926, correctly disallowed the deductions claimed by the Meridian & Memphis for amortization of bond discount.

[fol. 96] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 24887 and 42150

GULF, MOBILE & NORTHERN RAILROAD CO., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

[fol. 97] Docket Nos. 38295 and 42149

JACKSON & EASTERN RAILWAY COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket No. 35898

MERIDAN & MEMPHIS RAILWAY CO., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION

These proceedings came on to be heard in Washington, D. C., on September 23, 1931, pursuant to notice under Rule

50 for redetermination of the deficiencies in accordance with the findings of fact and opinion of the Board promulgated February 20, 1931, as modified by order this day entered, and, it appearing that the Gulf, Mobile and Northern Railroad Company had paid $14,161.44 of the tax for 1920 shown to have been assessed in the deficiency letter, and it further appearing that the net income of the Meridian and Memphis for 1922 was $18,461.06 and that the consolidated net income of the Gulf, Mobile and Northern and the Meridian and Memphis Railway for 1922 was $738,283.85, after deducting the 1921 consolidated net loss of $64,701.79, and that the total tax liability computed on such consolidated income was $92,285.48, of which $2,307.63 represents the liability of the Meridian and Memphis when apportioned according to the respective incomes of the two companies, and it appearing further that the Jackson & Eastern sustained net losses for 1921 and 1922 in the amounts of $7,068.80 and $738.10, respectively, which amounts are deductible in computing taxable net income for 1923, and the parties by their attorneys having agreed and stipulated the deficiencies, overassessments, and overpayments hereinafter set out, it is hereby

Ordered and decided that the deficiencies, overassessments and overpayments of petitioners for the respective years are as follows:

[fol. 98] Gulf, Mobile & Northern Railroad Co.:	
1920 deficiency	$711.97
1920 overassessment to be abated	8,022.86
1924 deficiency	9,582.62
1925 deficiency	14,640.54
1926 overassessment and overpayment	505.01
Meridian & Memphis Railway Co.:	
1922 deficiency	2,307.63
Jackson & Eastern Railway Co.:	
1923 overassessment and overpayment	101.37
1924 no deficiency	.....
1925 deficiency	1,176.18
1926 deficiency	91.72

(Signed) Charles M. Trammell, Member.

Entered Sept. 30, 1931.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.

(Seal U. S. Board of Tax Appeals.)

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 24887 and 42150

GULF, MOBILE & NORTHERN RAILROAD CO., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket Nos. 38295 and 42149

JACKSON & EASTERN RAILWAY COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket No. 35898

MERIDIAN & MEMPHIS RAILWAY CO., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

REVISED DECISION

On motion of counsel for petitioners, agreed to by counsel for respondent, it is hereby

[fol. 99] Ordered and decided that the decision entered September 30, 1931, is hereby set aside and vacated and the following decision entered herein:

These proceedings came on to be heard in Washington, D. C., on September 23, 1931, pursuant to notice under Rule 50 for redetermination of the deficiencies in accordance with the findings of fact and opinion of the Board promulgated February 20, 1931, as modified by order that day entered, and it appearing that the Commissioner of Internal Revenue in February, 1924, assessed a tax of $22,896.27 against the Gulf, Mobile & Northern Railroad Company for 1920, of which $14,161.44 has been paid, and that the correct tax liability for said year is $14,873.41; and it further appearing that the net income of the Meridian and Memphis Railway Company for 1922 was $18,461.06 and that the consolidated net income of the Gulf, Mobile and Northern Railroad Company and the Meridian and Memphis Railway Company for 1922 was $738,283.85, after deducting the 1921 consolidated

net loss of $64,701.79, and that the total tax liability computed on such consolidated income was $92,285.48, of which $2307.63 represents the liability of the Meridian and Memphis Railway Company when apportioned according to the respective incomes of the two companies, and it appearing further that the Jackson & Eastern Railway Company sustained net losses for 1921 and 1922 in the amounts of $7,068.80 and $738.10, respectively, which amounts are deductible in computing taxable net income for 1923, and the parties by their attorneys having agreed that the deficiencies, overassessments, and overpayments hereinafter set out are in accordance with the Board's findings and opinion, it is hereby

Ordered and decided that the unpaid assessments to be collected, the deficiencies, overassessments and overpayments of petitioners for the respective years are as follows:

	Gulf, Mobile & Northern Railroad Co.:	
1920	Unpaid assessment to be collected	$711.97
1920	Overassessment to be abated	8,022,86
1924	Deficiency	9,582.62
1925	Deficiency	14,640.54
1926	Overassessment and overpayment	505.01
[fol. 100]	Meridian & Memphis Railway Co.:	
1922	Deficiency	2,307.63
	Jackson & Eastern Railway Co.:	
1923	Overassessment and overpayment	101.37
1924	No deficiency	.....
1925	Deficiency	1,176.18
1926	Deficiency	91.72

(Signed) C. M. Trammell, Member.

Entered Nov. 7, 1931.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.

[Stamp:] Received Dec. 4, 1931, U. S. Board of Tax Appeals.

[File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Dockets 24887 and 42150, Docket 35898, Dockets 38295 and 42149

[Title omitted]

MOTION TO SET ASIDE FINAL DECISION, ETC.—Filed Dec. 4, 1931

Comes now the respondent, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and moves that the Board set aside its final decision entered in these appeals on November 7, 1931, and that it reconsider its decision promulgated February 20, 1931, with respect to the issue involving the question of whether or not the amount received by the petitioner, Gulf, Mobile & Northern Railroad Company, during the year 1920 as additional compen-
[fol. 101] sation for the transportation of United States mails pursuant to the award of the Interstate Commerce Commission rendered in "Railway Mail Pay," 56 I. C. C. 1, in view of the Board's decision in the case of the International-Great Northern Railroad Company v. Commissioner of Internal Revenue, promulgated November 11, 1921, with respect to a similar question wherein the Board specifically overruled its decision on this issue in the instant case.

(Signed) C. M. Charest, General Counsel, Bureau of Internal Revenue. Of Counsel: E. C. Algire, Special Attorney, Bureau of Internal Revenue.

ECA: RBI.

BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No-. 24887, 35898, 38295, 42149, 42150

[Title omitted]

ORDER GRANTING MOTION TO SET ASIDE FINAL DECISION, ETC.

This cause coming on to be heard upon the motion of the respondent to set aside the final decision entered in these proceedings on November 7, 1931, and to reconsider its decision promulgated February 20, 1931, with respect to the issue involving the question whether or not the amount received by the petitioner Gulf, Mobile & Northern Railroad
[fol. 102] Company during 1920 as additional compensa-

tion for the transportation of United States Mails pursuant to the award of the Interstate Commerce Commission, and it appearing that the decision of the Board in this proceeding with respect to that issue has been overruled by a subsequent decision of the Board in the case of International-Great Northern Railroad Company v. Commissioner of Internal Revenue, promulgated November 11, 1931, and after having heard the argument of counsel, and being fully advised in the premises, it is

Ordered that the motion be and the same is hereby granted. It is

Further ordered that the decision of the Board entered in these proceedings on November 7, 1931, be and the same is hereby modified in this respect. It is

Further ordered that the additional compensation for the transportation of United States mails received by the Gulf, Mobile & Northern Railroad Company in 1920 should be included in the taxable income for that year. It is

Further ordered that the amount of deficiency for 1920 be recomputed accordingly, and that the income for 1919 be reduced accordingly.

(Signed) Charles M. Trammell, Member United States Board of Tax Appeals.

b.

Entered Dec. 19, 1931.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal U. S. Board of Tax Appeals.)

BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket Nos. 24887, 42150

[Titles omitted]

[fol. 103] Docket Nos. 38295, 42149

Docket No. 35898.

ORDER MAKING OBJECTION AND EXCEPTION A MATTER OF RECORD

Whereas, an order heretofore entered in the above-entitled proceeding on December 19, 1931, wherein the previous findings of fact and opinion of the Board were amended so as to include in income for 1920 certain Railway Mail pay

over objection of counsel for the petitioner; and whereas counsel for petitioner objected of record and asked that the record show an exception; and whereas through inadvertence said order did not recite the objection and exception of petitioner, it is, therefore,

Ordered: That the objection and exception to said order be made a matter of record.

Signed) Charles M. Trammell, Member.

Dated Washington, D. C., December 21, 1931.

A true copy. Teste:

B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal U. S. Board of Tax Appeals.)

Before United States Board of Tax Appeals, Washington

Docket Nos. 24887, 42150

Gulf, Mobile & Northern Railroad Company, Petitioner,

v.

Commissioner of Internal Revenue, Respondent.

[fol. 104] Docket Nos. 38295, 42149

Jackson & Eastern Railway Company, Petitioner,

v.

Commissioner of Internal Revenue, Respondent

Docket No. 35898

Meridian & Memphis Railway Company, Petitioner,

v.

Commissioner of Internal Revenue, Respondent

Second Revised Decision

Pursuant to order of the Board entered December 19, 1931, and petitioners' motion for settlement this day filed, which motion is agreed to by respondent, it is hereby

Ordered and decided that the Revised decision entered November 7, 1931, is hereby set aside and vacated and the following decision is entered herein:

These proceedings came on to be heard in Washington, D. C., on this day, pursuant to notice under Rule 50 for redetermination of the deficiencies in accordance with the findings of fact and opinion of the Board promulgated Feb-

ruary 20, 1931, as modified by orders entered September 30, 1931, and December 19, 1931, and it appearing that the Commissioner of Internal Revenue in February, 1924, assessed a tax of $22,896.27 against the Gulf, Mobile and Northern Railroad Company for 1920, of which $14,161.44 has been paid, and that the correct tax liability for said year is $15,273.41; and it further appearing that the net income of the Meridian and Memphis Railway Company for 1922 was $18,461.06 and that the consolidated net income of the Gulf, Mobile and Northern Railroad Company and the Meridian and Memphis Railway Company for 1922 was $738,283.85, after deducting the 1921 consolidated net loss of $64,701.79, and that the total tax liability computed on such consolidated income was $92,285.48, of which $2,307.63 represents the liability of the Meridian and Memphis Railway Company when apportioned according to the respective incomes of the two companies; and it appearing [fol. 105] further that the Jackson & Eastern Railway Company sustained net losses for 1921 and 1922 in the amounts of $7,068.80 and $738.10, respectively, which amounts are deductible in computing taxable net income for 1923, and the parties by their attorneys having agreed that the deficiencies, overassessments, and overpayments hereinafter set out are in accordance with the Board's findings and opinion, it is hereby

Ordered and decided that the unpaid assessments to be collected, the deficiencies, overassessments and overpayments of petitioners for the respective years are as follows:

	Gulf, Mobile & Northern Railroad Co.:	
1920	Unpaid assessment to be collected	$1,111.97
1920	Overassessment to be abated	7,622.86
1924	Deficiency	9,582.62
1925	Deficiency	14,640.54
1926	Overassessment and overpayment	505.01
	Meridian & Memphis Railway Co.:	
1922	Deficiency	2,307.63
	Jackson & Eastern Railway Co.:	
1923	Overassessment and overpayment	101.37
1924	No deficiency	
1925	Deficiency	1,176.18
1926	Deficiency	91.72

Signed) Charles M. Trammell, Member.

Entered Jan. 25, 1932.

A true copy. Teste:
B. D. Gamble, Clerk U. S. Board of Tax Appeals.
(Seal U. S. Board of Tax Appeals.)

[fol. 106] [File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 24887, 42150

[Title omitted]

STIPULATION FOR COURT OF REVIEW—Filed July 25, 1932

It is hereby agreed and stipulated, by and between counsel for the respective parties, that a review of the decision and order of the United States Board of Tax Appeals in the above designated proceedings may be had before the Court of Appeals of the District of Columbia in accordance with the statutes made and provided, and regulations issued pursuant thereto.

(Signed) Geo. E. H. Goodner, Counsel for Petitioner. C. M. Charest, General Counsel, Bureau of Internal Revenue, Counsel for Respondent.

[File endorsement omitted]

IN THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA.

Board of Tax Appeals Docket Nos. 24887, 42150

[Title omitted]

PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS—Filed July 25, 1932

To the Honorable Chief Justice and the Associate Justices of the Court of Appeals of the District of Columbia:

Your appellant respectfully represents to the Court:

I. Jurisdiction

1. The Gulf, Mobile & Northern Railroad Company, appellant, is a corporation organized January 1, 1917, under

[fol. 107] the laws of the State of Alabama, and with principal office at 71 Conti Street, Mobile, Alabama. It succeeded another company of the same name which operated its properties as far back as 1907. Ever since organization it has been engaged in the operation of railroads. One of its subsidiary companies is the Meridian & Memphis Railway Company, a corporation organized under the laws of the State of Mississippi in 1911.

2. Appellee is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States.

3. Appellant heretofore appealed to the United States Board of Tax Appeals from letter of the Commissioner of Internal Revenue dated January 6, 1927, wherein the latter notified appellant of a proposed assessment against it of $14,731.74, representing alleged unpaid income taxes for the year 1920; also letter from said Commissioner dated November 6, 1928 notifying appellant of a proposed assessment against it of $27,056.23, representing alleged unpaid income taxes for the years 1924, 1925 and 1926. Said proceedings were given Docket Nos. 24887 and 42150 respectively by the Board.

On February 20, 1931 the Board promulgated its Findings of Fact and Opinion, as modified by Orders entered September 30, 1931 and December 19, 1931, and on January 25, 1932 entered its final Decision wherein it held that appellant's correct tax liability for 1920 was $15,273.41, of which $14,161.44 has been paid, leaving the sum of $1,111.97 as an unpaid assessment for the said year, and further entered that there was a deficiency for 1924 of $9,582.62, a deficiency for 1925 of $14,640.54 and an overassessment and overpayment for 1926 of $505.01.

4. Appellant desires a review by this Court of the Board's findings, opinion and decision on the issues as set out below and brings this action under the provisions of Section 1001, 1002 and 1003, of the Revenue Act of 1926, as amended by Section 603 of the Revenue Act of 1928.

II. Nature of the Controversy

1. From prior to December 31, 1917 to date, the Gulf, Mobile and Northern Railroad Company owned all the stock of the Meridian & Memphis Railway Company, and the two companies were affiliated for income tax purposes

[fol. 108] throughout the years involved in this proceeding. Consolidated returns were filed for the years 1920 to 1926 inclusive.

2. Appellant's railroad and equipment were taken over by the President of the United States, and were under control of the Director General of Railroads throughout the period from January 1, 1918 to February 29, 1920, inclusive. They were turned back to appellant at midnight on February 29, 1920, under the terms of Section 209 of the Transportation Act of 1920.

There was no written "standard agreement" between appellant and the Government in respect to Federal Control of its properties. After appellant's properties were returned to it on February 29, 1920, appellant and the Director General made a final settlement, as a result of which appellant paid to the Director General the sum of $100,000.00, which was in full of all charges against appellant.

Among the properties taken over by the President on December 31, 1917, were material and supplies which had cost appellant $286,664.26. The Director General turned back to appellant at the end of the control period material and supplies, the cost to him and the value of which was $275,912.03. In the aforesaid final settlement, petitioner was allowed the sum of $61,314.18 on its claim that the inventory of material and supplies turned back to it by the Director General was not equal in kind, grade and quality to the inventory of material and supplies which it turned over at the beginning of the period.

In computing the appellant's net income for 1920 appellee has included therein the sum of $50,561.95, arrived at by taking from the sum of the inventory of material and supplies turned back plus the amount allowed appellant in the final settlement, the amount of the original inventory.

When the President took over appellant's properties as of December 31, 1917, an entry was made on appellant's books charging the United States with $286,664.26, the cost of material and supplies. This entry stood until after the final settlement with the Director General, when it was cleared in 1920, with all the other accounts entered into said settlement, through the profit and loss account. This charge to the United States was not an account receivable, but was a memorandum charge, because appellant expected

[fol. 109] to have the material and supplies returned in kind, grade, and quality as the law provided.

Appellant contends that such transaction does not give rise to taxable income, because there was no sale or other disposition of property to the United States and that which was received was not more than sufficient to make it whole against the differences resulting from government control and operation of the properties.

3. In 1920 the Postmaster General paid to appellant the sum of $15,706.62 as additional compensation for carrying the mails in 1916 and 1917, under order of the Interstate Commerce Commission, Case No. 9200. Appellee has included $4,000.00 of this amount in 1920 income as determined by him. Appellant keeps its books on the accrual basis and contends that no part of said compensation for 1916 and 1917 constituted taxable income in 1920.

4. From 1913 to 1916, inclusive, appellant's subsidiary, the Meridian & Memphis Railway Company sold its bonds at a discount, and under the Interstate Commerce Commission rules it set up on its books the amount of the discount as a deferred charge to be amortized over the remaining life of the bonds. It has consistently written off each year the applicable part of said discount, and in the years 1924, 1925 and 1926 it wrote off $4,585.32 in each year, and that amount was claimed as a deduction in the consolidated tax returns for those years.

Appellee has disallowed the deduction on the ground that the bonds are intercompany obligations. Appellant contends that the deduction of the bond discount is not an intercompany transaction. The discount was a deferred charge incurred and entered on the books of the Meridian & Memphis Railway Co. before it became affiliated with the Gulf, Mobile & Northern Railroad Co., and before the latter acquired its bonds, and therefore is a proper deduction in computing income.

III. Assignments of Error

Petitioner as a basis for review makes the following assignments of error:

1. The Board of Tax Appeals erred in sustaining appellee's determination that there was a gain of $50,561.95 as

the amount returned to appellant for material and supplies [fol. 110] at the end of the Federal Control period, in excess of the amount of material and supplies taken over by the Director General at the beginning of the Federal Control period, the Board having failed to find that there was any evidence upon which it could base a conclusion as to the actual gain.

2. The Board of Tax Appeals erred in holding in its order dated December 19, 1931, that the additional compensation for the transportation of United States mails received by appellant in 1920, should be included in taxable income for that year.

3. The Board of Tax Appeals erred in holding that appellee correctly disallowed as a deduction the Meridian & Memphis Railway Co. bond discount of $4,585.32 for each of the years 1924, 1925 and 1926, in computing the consolidated net income of appellant and its subsidiary for those years.

4. The Board of Tax Appeals erred in determining that there was an unpaid assessment of $1,111.97 to be collected for the year 1920.

5. The Board of Tax Appeals erred in its determination of the amount of deficiencies for the years 1924 and 1925, and in its determination of the amount of the overassessment and overpayment for the year 1926.

Wherefore Appellant prays that this Honorable Court will review the said findings, opinion and decision of the Board of Tax Appeals, and reverse and set aside same insofar as the aforesaid assignments of error apply, and therein find for appellant, and grant such other and further relief as appellant may be entitled to or which to the Court may seem equitable and proper, including judgment for costs in this case.

Geo. E. H. Goodner, Attorney for Appellant. Address: Munsey Building, Washington, D. C. Josephus C. Trimble, of Counsel.

Duly sworn to by Josephus C. Trimble. Jurat omitted in printing.

[fol. 111] [File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket Nos. 24887 and 42150

GULF, MOBILE & NORTHERN RAILROAD COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Statement of Evidence—Lodged Oct. 18, 1932; Filed Oct. 20, 1932

The following is a statement of evidence in narrative form in the above-entitled cause. This cause came on for hearing before the Honorable Charles M. Trammel, Member of the United States Board of Tax Appeals, on April 2, 1930. George E. H. Goodner and Walter K. Smith appeared for the petitioner, and C. M. Charest, General Counsel, Bureau of Internal Revenue, appeared for the respondent.

Counsel for the petitioner moved that the appeals of the Gulf, Mobile & Northern Railroad Company, Dockets No. 24887, and 42150, the appeal of Meridian & Memphis Railway Company, Docket No. 35898, and the appeals of Jackson & Eastern Railway Company, Dockets Nos. 38295 and 42149, be consolidated for hearing. No objection was offered to this motion by counsel for respondent and the motion was granted by the Board.

The parties thereupon stipulated that petitioner and the other corporations involved in the consolidated proceeding [fols. 112–118] kept books and rendered income tax returns on the accrual basis of accounting.

MR. F. M. HICKS, a witness on behalf of Petitioner, testified on Direct Examination as follows:

My name is F. M. Hicks. I am 36 years old, and reside at Mobile, Alabama. I am Vice President of the Gulf, Mobile & Northern Railroad Company and have been such since 1925. I came to the Gulf, Mobile & Northern Railroad Company in March, 1919, as Corporate Auditor, which

position I held until the end of Federal Control when I was made Comptroller. I held that position until July 1, 1923, when I was made Traffic Manager and then followed on in the position of Vice President. During the period 1920, 1921 and 1922 I had direction of the filing of income tax returns. These returns were filed with the Collector of Internal Revenue at Birmingham, Alabama. The returns of the Meridian & Memphis Railway Company were filed at the same place.

[fol. 119] The Meridian & Memphis Railway Company bonds were pledged as collateral for some collateral trust notes of the Equitable Loan & Mortgage Company at the time we bought the stock of the Meridian & Memphis Railway Company. When we paid off the collateral trust notes at the end of Federal Control through the War Finance Corporation we came into possession of the Meridian & Memphis bonds.

We might have paid off the collateral trust notes at the time we bought the stock and took part possession of the bonds concurrently with the possession of the stock but we did not do that. The collateral trust notes matured during Federal Control and the War Finance Corporation took them up for us and we came into possession of the bonds after the end of Federal Control.

Mr. R. E. DeNeefe, a witness on behalf of Petitioner, testified on Direct Examination:

My name is R. E. DeNeefe. I reside in Mobile, Alabama, and am Comptroller of the Gulf, Mobile & Northern Railroad Company. As such I have supervision over all the accounting departments of the Company. I am familiar with the transaction involving the charge off by the Meridian & Memphis Railway Company of bonds discount in the amount of $4,585.32 in each of the years 1924, 1925, and 1926.

Bonds of the Meridian & Memphis Railway Company were sold from 1913 at various dates down through 1916. They had an authorized—their mortgage authorized an is-[fols. 120 & 121] suance of $800,000 worth of five per cent gold bonds. They actually issued $675,000 of bonds, disposed of those between the years 1913 and 1916 at a dis-

count of something like $131,000.00. Those bonds were sold by the Meridian & Memphis to the Equitable Loan & Mortgage Company of Mobile, as I said before between 1913 and 1916.

In the latter part of 1917 and the early part of 1918 the Gulf, Mobile & Northern Railroad Company made purchase of those bonds from the Equitable Loan & Mortgage Company, not the Meridian & Memphis. The bonds were bought there for something like $636,000. The deal was made effective and consummated as of January, 1918.

Under the rules of the Interstate Commerce Commission the discount would have to be spread over the life of the bonds. The bonds were issued as of January 1, 1913, thirty year bonds, so that we would amortize each year one-thirtieth of the total discount. That was done by the old Meridian & Memphis Railway Company on its books, and was continued after the Gulf, Mobile & Northern Railroad Company took over the bookkeeping of the Meridian & Memphis.

These items for these three years in question represented the amortization of that discount.

On cross-examination witness testified as follows:

I am not qualified to answer the question whether the Gulf, Mobile & Northern Railroad Company and the Meridian & Memphis Railway Company were affiliated at the time the former bought the bonds of the latter. Those bonds were purchased in 1918 and I have stated what our records show as to the discount on those bonds. Those records are here in Court and can be verified.

The Gulf, Mobile & Northern Railroad Company did not own the stock on the date the bonds were acquired. It acquired the stock and bonds simultaneously as I understand it. Probably Mr. Hicks can answer that.

The corporations were affiliated during the years on appeal and during the years in which we are claiming a deduction for the discount.

[fol. 122] The foregoing is a true and correct statement of all the proceedings which took place and of all the evidence which was offered at the hearing before the Board of Tax Appeals on April 2, 1930, which are material to the

issues now raised in the petition for review by the Court of Appeals, District of Columbia, filed by the Gulf, Mobile & Northern Railroad Company.

Geo. E. H. Goodner, Counsel for Petitioner. Address: Munsey Building, Washington, D. C

I have no objection to the foregoing statement.

C. M. Charest, General Counsel, Bureau of Internal Revenue, Counsel for Respondent.

Approved and settled this 20th day of October, 1932.

C. M. Trammell, Member U. S. Board of Tax Appeals.

[fol. 123] [File endorsement omitted]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Dockets Nos. 24887 and 42150

[Title omitted]

PRÆCIPE FOR TRANSCRIPT OF RECORD—Filed Oct. 18, 1932

To Mr. B. D. Gamble, Clerk of the U. S. Board of Tax Appeals:

Will you please include in the transcript of record for the Court of Appeals, District of Columbia, the following:

1. The docket entries of proceedings before the Board.

2. The pleadings before the Board which should include the following:

a. Petition No. 24887 filed March 3, 1927.

b. Answer filed June 22, 1927.

c. Amended answer filed March 8, 1930.

d. Amended petition filed April 2, 1930.

e. Answer to amended petition dictated orally at the hearing on April 2, 1930 (copy from pages 7-14 of transcript attached hereto).

f. Petitioner's reply to answer to amended petition dictated orally at the hearing on April 2, 1930 (copy from pages 14-16 of transcript attached hereto).

g. Petition No. 42150 filed December 31, 1928.

h. Answer to 42150 filed ——, ——.

3. The findings of fact and opinion of the Board promulgated February 20, 1931.

4. The Board's decision entered Sept. 30, 1931.

5. The Board's revised decision entered Nov. 7, 1931.

6. Respondent's motion filed Dec. 4, 1931.

7. Board's order entered December 19, 1931.

8. Board's order entered Dec. 21, 1931.

9. Board's second revised decision entered Jan. 25, 1932.

[fols. 124–126] 10. The stipulation as to the court of review.

11. The petition for review.

12. The statement of evidence.

13. This præcipe.

Respectfully, Geo. E. H. Goodner, Attorney for Petitioner. Address: Munsey Building, Washington, D. C.

Service of copy of above præcipe on me this 18th day of October, 1932, accepted.

C. M. Charest, General Counsel, Bureau of Internal Revenue, Attorney for Respondent.

Clerk's certificate to foregoing transcript omitted in printing.

127 Monday, July 17th, A. D. 1933.

GULF, MOBILE & NORTHERN RAILROAD CO., Appellant,
vs.
DAVID BURNET, Commissioner of Internal Revenue. } No. 5854.

On consideration of the motion filed herein by counsel for the appellant to substitute Guy T. Helvering, Commissioner of Internal Revenue, for David Burnet, retired, and counsel for the Commissioner of Internal Revenue expressly consenting thereto, it is ordered by the Court that Guy T. Helvering, Commissioner of Internal Revenue, be and he is hereby substituted as party appellee in the above entitled cause in the place and stead of David Burnet, retired.

128 Tuesday, November 7th, A. D. 1933.

GUY T. HELVERING, Commissioner of Internal Revenue, Appellant,
vs.
GULF, MOBILE AND NORTHERN RAILROAD CO. } No. 5853.

and

GULF, MOBILE & NORTHERN RAILROAD CO., Appellant,
vs.
GUY T. HELVERING, Commissioner of Internal Revenue. } No. 5854.

The argument in the above entitled causes was commenced by Mr. G. E. H. Goodner, attorney for the taxpayer, and was continued by Mr. M. K. Rothschild, attorney for the Commissioner of Internal Revenue.

(Mr. Justice Van Orsdel not sitting.)

129 Wednesday, November 8th, A. D. 1933.

GUY T. HELVERING, Commissioner of Internal Revenue, Appellant, vs. GULF, MOBILE and NORTHERN RAILROAD Co. — No. 5853.

and

GULF, MOBILE & NORTHERN RAILROAD Co., Appellant, vs. GUY T. HELVERING, Commissioner of Internal Revenue. — No. 5854.

The argument in the above entitled causes was continued by Mr. M. K. Rothschild, attorney for the Commissioner of Internal Revenue, and was concluded by Mr. G. E. H. Goodner, attorney for the taxpayer.

(Mr. Justice Van Orsdel not sitting.)

130 Court of Appeals of the District of Columbia

No. 5853

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE petitioner

v.

GULF, MOBILE & NORTHERN RAILROAD COMPANY, respondent

No. 5854

GULF, MOBILE & NORTHERN RAILROAD COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE respondent

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On Petitions for Review of the Decision of the United States Board of Tax Appeals

(*Argued Nov. 8, 1933. Decided May 14, 1934.*)

G. A. Youngquist, Sewall Key, Morton K. Rothschild, special assistants to the Attorney General; *E. Barrett Prettyman,*

general counsel, Bureau of Internal Revenue; and *E. C. Algire*, special attorney, Bureau of Internal Revenue, all of Washington, D. C., for petitioner.

Geo. E. H. Goodner, of Washington, D. C., for respondent.

Before Martin, Chief Justice, and Robb, Hitz, and Groner, Associate Justices.

MARTIN, *Chief Justice:* These cases relate to income taxes for the years 1920 to 1926. They were heard together by the Board of Tax Appeals and will be considered together by us in this decision.

The issues arise upon the consolidated income-tax return for the year 1920, of the Gulf, Mobile and Northern Railroad Company, and its affiliates, the Meridian and Memphis Railway Company and the Jackson and Eastern Railway Company.

The Gulf, Mobile and Northern Railroad Company, hereinafter called the railroad company, was the owner and in control of a railroad system extending through several southwestern States, and on December 26, 1917, its properties including
131 those of the affiliated companies were taken over by proclamation of the President of the United States, acting under the Federal Control Act of March 21, 1918, and were operated by the Director General of Railroads during the period of Federal control, namely, from January 1, 1918, to midnight February 29, 1920.

Prior to Federal control the railroad company had commenced the construction of a line of railroad in Mississippi known as the "Blodgett Branch," and an extension of its railroad in Tennessee, known as the "Jackson Extension." Both of these projects were for the purpose of removing timber from virgin territories. The "Blodgett Branch" was completed and put into operation during the year 1918, and the "Jackson Extension" was completed and put into operation in September, 1919. These extensions when completed were likewise taken under Federal control and operated by the Director General as part of the system.

The Federal Control Act, enacted March 21, 1918 (40 Stat. 451), provides in part as follows:

"SEC. 1. That the President, having in time of war taken over the possession, use, control, and operation (called herein Federal control) of certain railroads and systems of transporta-

tion (called herein carriers), is hereby authorized to agree with and to guarantee to any such carrier making operating returns to the Interstate Commerce Commission, that during the period of such Federal control it shall receive as just compensation an annual sum, payable from time to time in reasonable installments, for each year and pro rata for any fractional year of such Federal control, not exceeding a sum equivalent as nearly as may be to its average annual railway operating income for the three years ended June thirtieth, nineteen hundred and seventeen. * * *

"SEC. 2. That if no such agreement is made, or pending the execution of an agreement, the President may nevertheless pay to any carrier while under Federal control an annual amount, payable in reasonable installments, not exceeding ninety per centum of the estimated annual amount of just compensation * * *."

* * * * * * * * * * *

"SEC. 4. That the just compensation * * * shall be increased by an amount reckoned at a reasonable rate per centum to be fixed by the President upon the cost of any additions and betterments, less retirements, and upon the cost of road extensions to the property of such carrier made by such carrier with the approval of or by order of the President while such property is under Federal control."

In this instance the railroad company did not enter into the "standard agreement," its compensation therefore fell within the provisions of section 2 and 4 of the act.

In the final settlement with the Director General in the year 1920, the railroad company was allowed the sums respectively of $75,000 and $56,521.02, as additional compensation to it for the use of its "Blodgett Branch" and "Jackson Extension," during parts of the Federal control period. These amounts were based upon an estimate of the earnings which would have accrued to the railroad company during the period of Federal control if the projects were put into operation, and the
132 railroad company had been permitted to operate them itself. No part of either of these amounts was included by the railroad company in the consolidated net taxable income return as reported to the Commissioner of Internal Revenue for the year 1920. The Commissioner, however, held that the total amounts thus received in 1920, constituted taxable income for that year, and determined a deficiency accordingly, from

which decision the railroad company appealed to the Board of Tax Appeals.

It appears that the railroad company and its affiliates kept their accounts and made their tax returns upon the accrual basis, and the Board of Tax Appeals held that the amounts thus received by them constituted taxable income accruing during the years 1918, 1919, and part of 1920, comprising the period of Federal control, and were to be prorated proportionately during such periods. Accordingly the Board redetermined the deficiency declared by the Commissioner and held that only such proportion of the compensation aforesaid as was proratably allocable to the period from January 1 to March 1, 1920, should be included in the return for the year 1920.

The Commissioner, as petitioner in case no. 5853, supra, contends that the Board of Tax Appeals erred in holding that the amount of compensation paid by the Director General to the railroad company for the use of the extensions should be assessed proratably during the period of Federal control, contending that the amounts were not determined nor paid until the final settlement in 1920, and that they accrued in their entirety and were returnable in that year.

The question thus presented is whether the amounts paid as aforesaid by the Director General to the railroad company for the use of the extensions in the year 1920, but covering the entire period of Federal control, should be allocated proratably for income-tax purposes between the 2 years and 2 months of Federal control, or should be returnable in their entirety for the year 1920. The Board as stated, held against the Commissioner upon this proposition.

It has been invariably held by the Board of Tax Appeals and the courts that the "just compensation," allowed and paid by the Director General in the final settlement for use of a railroad company's property during the Federal-control period, constitutes income accruing proratably over the entire period of control. *Illinois Terminal Co.*, 5 B. T. A. 15; *The K. C. Southern Ry. Co.*, 16 B. T. A. 665, affirmed (8th C. C. A.) 52 F. (2d) 372; *Midland Valley Railroad Co.*, 19 B. T. A. 423, affirmed (10th C. C. A.) 57 F. (2d) 1042; *Helvering* v. *St. Louis S. W. Ry. Co.*, 66 F. (2d) 633 (certiorari denied, April 2, 1934), — U. S. —; *Continental Tie & Lumber Co.* v. *United*

States, 286 U. S. 290. From an income-tax standpoint we are unable to see any difference between the compensation paid for the use of the property held and used throughout the Federal-control period, and compensation for the use of property held and used during part of such period. The language of the act indicates that the compensation payable to the carriers should be payable in annual sums for the use of their property. Even if the compensation be determined and agreed upon at a later date and paid in a lump sum, it is still compensation which accrues during the period of control and use. It may be noted again that the taxpayer in this case was on the accrual basis of accounting and rendering tax returns. The question therefore is when did the income under review accrue in contemplation of the act. The Board decided that it accrued proratably throughout the
133 period during which the property was in the control and use of the Government. This decision is sustained by the fact that in the respective years of Federal control a reasonable estimate of "just compensation" could be made for the use of the two extensions and the facts upon which the obligation rested existed. It follows that the income in question accrued to the railroad company proratably during the control period as held by the Board of Tax Appeals. In our opinion therefore the decision of the Board of Tax Appeals in case no. 5853 was correct and should be affirmed.

In case no. 5854 the railroad company as petitioner complains of the determination of the Commissioner of Internal Revenue upon two grounds.

As a first cause of complaint it alleges that among the properties of the railroad company taken over by the President on December 3, 1917, were certain materials and supplies which had cost the company $286,664.26. The Director General at the end of the control period turned back certain materials and supplies the cost and value of which was $275,912.03. In the final settlement the company was allowed the sum of $61,314.18 on its claim for shortages in the inventory of materials and supplies turned back by the Director General as compared with those turned over to him at the beginning of the period.

In computing the company's net income for 1920 the Commissioner included therein as taxable income the sum of

$50,561.95, arrived at by taking from the sum of the inventory of materials and supplies turned back plus the amount allowed taxpayer in the final settlement, the amount of the original inventory. The Board of Tax Appeals approved this action of the Commissioner. It is claimed by the company that this was error.

We can not agree with this contention. Article 49 of Treasury Regulations 45 (1920) provides that where the owner of property has transferred title by reason of the exercise of the power of eminent domain, and has received compensation in excess of its cost or value on March 1, 1913, and the owner does not elect to replace or restore the property, the transaction will be deemed to be completed, and the excess of the value received over the cost or value on March 1, 1913, is subject to tax as if resulting from a sale. This provision has been included in the Treasury Regulations from 1918 until 1933. The reenactment of the statutory provision without material change must be deemed to constitute legislative approval of the administrative construction. *Brewster* v. *Gage*, 280 U. S. 327, 337.

The Circuit Court of Appeals for the Second Circuit upheld the regulations in question in *Lehigh & Hudson River Ry. Co.* v. *Commissioner*, 36 F. (2d) 719, certiorari denied, 281 U. S. 748. In that case, which involved similar circumstances, the court said:

"Such a transaction is equivalent for tax purposes to a sale of the supplies at the agreed price. The act of 1918 (40 Stat. 1057), did not, indeed, expressly provide for gains arising from the requisition of property, but article 49 of the regulations did: 'When the owner of property has lost or transferred title by reason of requisition or eminent domain * * * if the taxpayer does not elect to replace or restore the property, the transaction
will then be deemed to be completed and the income
134 shall be measured by the excess of the amount of the
compensation over the cost of the property.' This article and article 50 prescribed the formalities by which the election should be manifested, with none of which the railway conformed * * *."

In our opinion the foregoing contention of the railroad company must be overruled.

As second cause of complaint the railroad company contends that from 1913 to 1916, inclusive, its subsidiary, the Meridian and Memphis Railway Company, sold its corporate bonds at a

discount, and under the Interstate Commerce Commission's rules it set up on its books the amount of the discount as deferred charges to be amortized over the remaining life of the bonds; that the subsidiary company had consistently written off each year the applicable part of such discount, and in each of the years 1924, 1925, and 1926 it wrote off $4,585.32. The railroad company accordingly claimed an equal sum as a deduction in the consolidated tax returns for those years. The Commissioner disallowed the deduction on the ground that the bonds had been purchased and were held by the affiliated railroad company, and that the sum of the annual amortization was an inter-company obligation, and was not deductible.

Article 636 of Treasury Regulations 65 relates to the Revenue Act of 1924, and provides that intercompany transactions are subject to elimination from the consolidated taxable net income of the affiliated corporations. Article 635 of Treasury Regulations 69 relating to the Revenue Act of 1926 contains the same provision. In the instant case one member of the affiliated group acquired the bonds of another member. The Treasury Department has consistently construed such a transaction to be an intercompany transaction and has consistently held that it should be eliminated from a return of the consolidated taxable net income. *Old Mission Portland Cement Co.*, 25 B. T. A. 305, affirmed C. C. A. 9th, March 12, 1934, —F. (2d) —. We conclude therefore that the Board was right in holding that no deduction was allowable in the consolidated return of the railroad companies because of the amount entered by the affiliated company upon its books for the annual amortization of its bonds which at the time were held by its associate company.

Accordingly in each of the two cases, to wit, no. 5853 and no. 5854, the decision of the Board of Tax Appeals is affirmed.

A true copy.

Test:

Mr. Justice Groner concurs in the conclusion.

Clerk, Court of Appeals, D. C.

135 Monday, May 14th, A. D. 1934.

GULF, MOBILE & NORTHERN RAILROAD CO., Petitioner,
vs.
GUY T. HELVERING, Commissioner of Internal Revenue.
No. 5854, April Term, 1934.

Petition for review from the Board of Tax Appeals.

This cause came on to be heard on the transcript of the record from the Board of Tax Appeals and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the decision of the said Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

per Mr. Chief Justice Martin,
May 14, 1934.

Mr. Justice Groner concurs.

Mr. Justice Van Orsdel took no part in the consideration or decision of this case.

136 Monday, June 25th, A. D. 1934.

GULF, MOBILE & NORTHERN RAILROAD COMPANY, Petitioner,
vs.
GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.
No. 5854.

Modification.

Now on this 25th day of June, 1934, the court upon a reconsideration of its judgment in cases number 5853 and 5854 enters a modification thereof to the following effect to wit: It appearing that in the decision of the Board of Tax Appeals the sum of $4,000 of additional compensation paid to the petitioner, the Gulf, Mobile and Northern Railroad Company, for carrying the mails in 1916 and 1917 was included in petitioner's taxable income as determined for the year 1920 and that petitioner duly excepted thereto; and it appearing that the respondent, the commissioner of Internal Revenue, in his brief filed in this court in the present appeal conceded that

under the facts as found by the Board of Tax Appeals the additional compensation aforesaid for the transportation of mail should not be accrued during the year 1920 as was found and ordered by the Board; the court now modifies its decision as heretofore entered in case No. 5854 and affirms the decision of the Board made therein but nevertheless reverses that part of the decision affecting the $4,000 item now referred to, with instructions that the said amount of $4,000 should not be considered as accrued in the year 1920, and that petitioner's taxes for that year be recomputed accordingly.

137 UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA

GULF, MOBILE & NORTHERN RAILROAD COMPANY, Appellant, *v.* GUY T. HELVERING, as Commissioner of Internal Revenue (substituted for David Burnet), Respondent.	No. 5854.

Præcipe.

Mr. Henry W. Hodges, Clerk,
United States Court of Appeals, D. C.
Sir:

Will you kindly prepare and certify for filing in the Supreme Court of the United States, the record in the above designated cause, including therein

1. The printed record before the Court from the Board of Tax Appeals.
2. The Court's order substituting Helvering for Burnet.
3. The argument and submission.
4. The Court's Opinion.
5. The Court's Decree.
6. The Court's Order Modifying Opinion and Decree.
7. This præcipe.
8. Your certificate.

Respectfully,

(Signed) GEO. E. H. GOODNER,
Attorney for Appellant.

Dated September 20, 1934.

Address: Munsey Bldg.,
Washington, D. C.

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No. 5854.

GULF, MOBILE & NORTHERN RAILROAD COMPANY
Appellant
v.
GUY T. HELVERING, et al
Respondent.

ORDER FOR RECORD

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA.

Filed September 20, 1934.
HENRY W. HODGES,
Clerk.

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UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

I, HENRY W. HODGES, Clerk of the United States Court of Appeals for the District of Columbia, do hereby certify that the foregoing printed and typewritten pages numbered from 1 to 138, inclusive, are a true copy of the transcript of record and proceedings of said Court of Appeals as designated by counsel in the case of

Gulf, Mobile & Northern Railroad Co., Appellant,

vs.

Guy T. Helvering, Commissioner of Internal Revenue, No. 5854, April Term, 1934, as the same remain upon the files and records of said Court of Appeals.

IN TESTIMONY WHEREOF, I hereunto subscribe my name and affix the seal of said Court of Appeals, at the City of Washington, this 20th day of September, A. D. 1934.

HENRY W. HODGES,
Clerk of the United States Court of Appeals for the District of Columbia.
By: MONCURE BURKE,
Deputy Clerk.

[SEAL]

[fol. 140] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed November 5, 1934

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia is granted, limited to the question of the right of the taxpayer to deductions on account of amortization of bond discount, and the case is assigned for argument immediately following No. 107.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 141] SUPREME COURT OF THE UNITED STATES

STIPULATION AS TO PRINTING RECORD—Filed Nov. 6, 1934

The above designated parties, through their respective attorneys, hereby agree and stipulate that, in printing the additional copies of the Transcript of Record under the Court's Order entered November 5, 1934, wherein it granted the Petition for Writ of Certiorari, limited to the question of the right of the taxpayer to take deductions on account of amortization of bond discount, the following parts of the printed record, which are not material to the issue to be considered by the Court, shall be omitted, namely:

1. Commencing with line 1 on page 1 and continuing through and including the last line on page 4.
2. Commencing with line 29 on page 7 and continuing to but not including line 19 on page 30.
3. Commencing with line 25 on page 51 and continuing to but not including line 22 on page 53.
4. Commencing with line 16 on page 54 and continuing to but not including line 11 on page 56.

[fol. 142] 5. Commencing with line 30 on page 56 and continuing to but not including line 15 on page 61.

6. Commencing with line 1 on page 62 and continuing to but not including line 22 on page 66.
7. Commencing with line 24 on page 66 and continuing to but not including line 16 on page 88.

8. Commencing with line 29 on page 88 and continuing to but not including line 28 on page 96.

9. Commencing with line 19 on page 112 and continuing to but not including line 14 on page 119.

10. Commencing with line 39 on page 120 and continuing to but not including line 21 on page 122.

11. Commencing with line 1 on page 125 and continuing to but not including line 8 on page 126.

Geo. E. H. Goodner, Attorney for Petitioner.
J. Crawford Biggs, Solicitor General.

Endorsed on cover: File No. 39,041. U. S. Court of Appeals, District of Columbia. Term No. 413. Gulf, Mobile & Northern Railroad Company, petitioner, vs. Guy T. Helvering, as Commissioner of Internal Revenue. Petition for a writ of certiorari and exhibit thereto. Filed September 25, 1934. File No. 413, O. T., 1934.

FILE COPY

SEP 25

Supreme Court of the United States.

OCTOBER TERM, 1934.

No. 413

GULF, MOBILE & NORTHERN RAILROAD COMPANY,
PETITIONER,

v.

GUY T. HELVERING, AS COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS DISTRICT OF COLUMBIA

AND

SUPPORTING BRIEF.

Geo. E. H.
Murray
Washington, D.
Counsel for Petitioner.

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Supreme Court of the United States.

OCTOBER TERM, 1934

GULF, MOBILE & NORTHERN RAILROAD COMPANY,
Petitioner,
v.
GUY T. HELVERING, as Commissioner of Internal Revenue,
Respondent.
} No.....

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS, DISTRICT OF COLUMBIA.

This is a petition for a writ of certiorari to the United States Court of Appeals, District of Columbia, involving a decision by that Court in the case of Gulf, Mobile & Northern Railroad Company v. Guy T. Helvering, as Commissioner of Internal Revenue (substituted for David Burnet, Commissioner of Internal Revenue, R. 127), No. 5854, wherein the Court affirmed a decision of the United States Board of Tax Appeals upon the two questions here presented. The Court's opinion was entered on May 14, 1934 (R. 128-134), and the Court's judgment was entered on May 14, 1934 (R. 135). A modified judgment was entered June 25, 1934 (R. 135-136). The opinion of the Board of Tax appeals is reported at 22 B. T. A. 233.

Petitioner will hereinafter be referred to as the "taxpayer."

QUESTIONS PRESENTED.

The case presents the following questions:

1. What is the correct method of computing taxpayer's profit, if any, when it turned over to the President of the United States on December 31, 1917, under the provisions of the Federal Control Act, its inventory of material and supplies costing $286,664.26, and on February 29, 1920, received back through the Director General of Railroads an inventory of material and supplies which had cost the Director General $275,912.03, and later in the final settlement with the Director General received $61,314.18 as settlement in full of the account?

2. When taxpayer and its subsidiary, the Meridian & Memphis Railway Company, are affiliated for income tax purposes under the law in 1924, 1925, and 1926, and taxpayer owns the outstanding bonds of the subsidiary, and the latter writes off in each of those years an aliquot part of the discount at which it originally sold its bonds to the public before taxpayer had acquired any of its stock or bonds, and deducts such amounts from income in the respective years, are such transactions inter-company transactions so as to prevent the deductions in the consolidated returns?

SUMMARY STATEMENT OF THE MATTER INVOLVED.

1. Taxpayer is a corporation organized January 1, 1917, with principal office at Mobile, Alabama. Ever since organization it has been engaged in operating the Gulf, Mobile & Northern Railroad system (R. 21, Item 5 (a) of amended petition, admitted in answer, R. 26; R. 56).

Taxpayer's railroad and equipment were taken over by the President of the United States under the Federal Control Act on December 31, 1917, and were under the control of the Director General of Railroads throughout the period January 1, 1918, to February 29, 1920, inclusive. Included therein was an inventory of material and supplies which

had cost taxpayer $286,664.26. The properties were turned back to taxpayer at midnight on February 29, 1920, under the terms of the Transportation Act of 1920. The material and supplies turned back had cost the Director General $275,912.03 (R. 58).

There was no written "standard agreement" between taxpayer and the Government in respect to Federal Control of its properties. After the properties were returned to taxpayer on February 29, 1920, it made a final settlement with the Director General in which it was allowed $61,314.18 as settlement in full of the material and supply account (R. 58).

In the aforesaid final settlement, taxpayer was allowed the sum of $61,314.18 on its claim for *shortages* in the inventory of material and supplies turned back to it by the Director General over the inventory of material and supplies which it turned over at the beginning of the period (R. 112-114).

When the President took over taxpayer's properties as of December 31, 1917, an entry was made on its books charging the United States with $286,664.26, the cost of material and supplies. This entry stood until after the final settlement with the Director General, when it was cleared in 1920, with all the other accounts entering into said settlement, through the profit and loss account. This charge to the United States was not an account receivable, but was a memorandum charge, because taxpayer expected to have the material and supplies returned in kind, grade, and quality as the law provided (R. 114-115, 118-119).

In computing the taxpayer's net income for 1920 the Commissioner included therein the sum of $50,561.95, arrived at by taking from the sum of the inventory of material and supplies turned back plus the amount allowed taxpayer in the final settlement, the amount of the original inventory. The Board of Tax Appeals approved this action of the Commissioner (R. 58, 82-84) and the Court affirmed the Board (R. 135).

2. During 1913 to 1916, inclusive, taxpayer's subsidiary, the Meridian & Memphis Railway Company, sold its bonds at a discount and, under the Interstate Commerce Commission rules, set up on its books the amount of its discount as a deferred charge to be amortized over the remaining life of the bonds. It has consistently written off each year the applicable part of said discount and, in each of the years 1924, 1925, and 1926, it wrote off $4,585.32 and deducted that amount from its income for the respective years (R. 61, 119, 126).

On or about January 1, 1917, taxpayer acquired all of the stock of the Meridian & Memphis Railway Company so that the two companies were affiliated for income tax purposes from that time until after 1926, the last year involved in this proceeding (R. 56).

Soon after February 29, 1920, taxpayer acquired all of the outstanding bonds of the Meridian & Memphis Railway Company and held them until after 1926, the last year involved in this proceeding (R. 61).

In the consolidated returns, filed by taxpayer for itself and the Meridian & Memphis Railway Company, a deduction of $4,585.32 was taken each year in respect of the aforesaid bond discount amortization of the Meridian & Memphis Railway Company. The Commissioner of Internal Revenue disallowed the deductions on the ground that the bonds were inter-company obligations and that the writing off of the discount constituted an inter-company transaction (R. 38, 61). The Board of Tax Appeals approved the Commissioner's determination (R. 88), and the Court affirmed the Board (R. 135).

REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT.

1. This Court should grant certiorari on the material and supply question for the following reasons:

(a) The decision of the Court of Appeals is in conflict with the principle enunciated in the decision of the Circuit

Court of Appeals, Second Circuit, in *Lehigh & Hudson River Railway Company* v. *Commissioner,* 36 Fed. (2d) 721. (See brief, *infra.*)

(b) The question is an important question in revenue taxation affecting a great many railroads whose tax cases have not yet been settled.

(c) In approving the Commissioner's determination, the Court of Appeals overlooked the fact that there was no sale of the inventory of materials and supplies by taxpayer and that the cash payment was *only* for the quantity of material and supplies which the Director General was not able to return in kind; in other words, the Court of Appeals overlooked the provisions of the Federal Control Act whereby the President, or his agencies, were required to return the property in kind at the end of the control period, in consequence of which the cash settlement must necessarily be payment only for the material not returned. (See brief, *infra.*)

(d) The Commissioner's method of computing the profits, and therefore the Court's approval thereof, is wrong on the face of it, when the facts and law are taken into consideration. (See brief, *infra.*)

2. This Court should grant certiorari on the bond discount question for the following reasons:

(a) It is a very important question in Federal taxation affecting numerous other taxpayers and arising frequently under the various revenue acts.

(b) The Commissioner's determination, approved by the Court, does not conform to the generally accepted definition of an inter-company transaction. (See brief, *infra.*)

(c) No reason has ever been given by the Board or any Court to support the Court's position taken in this case. The first time the question arose before the Board of Tax Appeals, which was in *New Orleans, Texas and Mexico Railroad Co.,* 6 B. T. A. 436, the Board, without discussing the question, decided it on the authority of another case which did not decide the question at all. Since then, every

time the question has arisen, either before the Board or in the Courts, it has been decided, without comment, on the authority of the Board's decision in the *New Orleans, Texas and Mexico Railroad Co.* case, *supra,* where, as stated, the supporting authority was not in point at all. (See brief, *infra.*)

(d) The writing off of bond discount by the Meridian & Memphis Ry. Co. was the writing off of a deferred charge which does not affect the income of taxpayer in any way any more than the writing off of depreciation would affect taxpayer. It is therefore not an inter-company transaction and this Court should grant certiorari and decide the question, once and for all, in order to prevent the great number of erroneous decisions which will follow on bond discount and analogous questions in consolidated cases unless this Court speaks.

(e) The decision of the Court of Appeals is in direct conflict with the principles enunciated in

Alpha Portland Cement Co. v. *U. S.* (Ct. Cls.), 44 Fed. (2d) 92;

Hernandez v. *Charles Ilfeld Co.* (10 C. C. A.), 66 Fed. (2d) 236.

(See brief, *infra.*)

(f) Finally, the decision of the Court of Appeals is directly in conflict with the principle enunciated in the decision of this Court in

Burnet v. *Aluminum Goods Mfg. Co.,* 287 U. S. 544, 53 S. Ct. 227,

wherein this Court held that a real loss of one member of an affiliated group, which was also a real loss of the single business of the group, was deductible in computing the consolidated income of the group.

WHEREFORE, your petitioner prays that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Court of Appeals, District of Columbia, commanding that Court to certify and transmit to this Court for review and determination on a date to be therein named, a full and complete transcript of the record and of the proceedings in the case numbered and entitled on its docket No. 5854, *Gulf, Mobile & Northern Railroad Company,* appellant, v. *Guy T. Helvering,* as Commissioner of Internal Revenue (substituted), appellee; and that said judgment of said Court be reversed by this Honorable Court on the questions here raised and that your petitioner have such other and further relief in the premises as to this Honorable Court may seem meet and just, and your petitioner will ever pray.

GEO. E. H. GOODNER,
Counsel for Petitioner,
Address: Munsey Building,
Washington, D. C.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The opinion of the United States Court of Appeals, District of Columbia, was entered May 14, 1934, and appears in the printed record at pages 128 to 134, inclusive. The Court's judgment was entered May 14, 1934, and appears at page 135 of the record.

The Court's modified judgment was entered June 25, 1934, and appears at pages 135-136 of the record.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended by the Act of February 13, 1925, and under Section 1003 of the Revenue Act of 1926.

FACTS.

The facts are set out in the petition above in the "Summary Statement of the Matter Involved" and for the sake of brevity are not repeated here.

STATUTES AND REGULATIONS.

This case involves the following provisions of law and regulations:

Federal Control Act enacted March 21, 1918:

> Sec. 1. That the President, having in time of war taken over the possession, use, control, and operation (called herein Federal control) of certain railroads and systems of transportation (called herein carriers), is hereby authorized to agree with and to guarantee to any such carrier making operating returns to the Interstate Commerce Commission, that during the period of such Federal control it shall receive as just compensation an annual sum, payable from time to time in rea-

sonable installments, for each year and pro rata for any fractional year of such Federal control, not exceeding a sum equivalent as nearly as may be to its average annual railway operating income for the three years ended June thirtieth, nineteen hundred and seventeen.

That any railway operating income accruing during the period of Federal control in excess of such just compensation shall remain the property of the United States. * * *

Every such agreement shall also contain adequate and appropriate provisions for the maintenance, repair, renewals, and depreciation of the property, for the creation of any reserves or reserve funds found necessary in connection therewith, and for such accounting and adjustments of charges and payments both during and at the end of Federal control as may be requisite in order that the property of each carrier may be returned to it in substantially as good repair and in substantially as complete equipment as it was in at the beginning of Federal control. * * *

Sec. 2. That if no such agreement is made, or pending the execution of an agreement, the President may nevertheless pay to any carrier while under Federal control an annual amount, payable in reasonable installments, not exceeding ninety per centum of the estimated annual amount of just compensation, remitting such carrier, in case where no agreement is made, to its legal rights for any balance claimed to the remedies provided in section three hereof. * * *

Sec. 4. That the just compensation that may be determined as hereinbefore provided by agreement or that may be adjudicated by the Court of Claims, shall be increased by an amount reckoned at a reasonable rate per centum to be fixed by the President upon the cost of any additions and betterments, less retirements, and upon the cost of road extensions to the property of such carrier made by such carrier with the approval of or by order of the President while such property is under Federal control.

Revenue Act of 1924:

Sec. 240. (a) Corporations which are affiliated within

the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of the net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. * * *

(b) In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit. * * *

Section 240 of the Revenue Act of 1926 contains identical provisions applying to the years 1925 and 1926.

Treasury Regulations 65 (applicable to 1924):

Art. 545. * * * * * * * *

(3) (a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds.

Art. 636. Consolidated net income of affiliated corporations.—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated.

Articles 545 and 635 of Regulations 69, applicable to 1925 and 1926, contain the identical provisions.

SPECIFICATIONS OF ERROR.

Taxpayer makes the following assignments of error, which will furnish the basis of the following argument:

1. The Court of Appeals, District of Columbia, erred in sustaining the determination of the Commissioner and the Board that there was a gain of $50,561.95 in the amount returned to taxpayer for material and

supplies at the end of the Federal Control period, in excess of the amount of material and supplies taken over at the beginning of the Federal Control period.

2. The Court of Appeals, District of Columbia, erred in holding with the Commissioner and the Board, that the deductions of $4,585.32 taken by the Meridian & Memphis Railway Company in each of the years 1924, 1925, and 1926 in amortizing its bond discount, were not allowable deductions in computing consolidated net income for those years.

ARGUMENT.

1. The Court of Appeals, District of Columbia, erred in sustaining the determination of the Commissioner and the Board that there was a gain of $50,561.95 in the amount returned to taxpayer for material and supplies at the end of the Federal Control period, in excess of the amount of material and supplies taken over at the beginning of the Federal Control period.

At the close of business December 31, 1917, taxpayer had on hand an inventory of material and supplies which had cost $286,664.26. On January 1, 1918, the President of the United States took over its properties and along with them the said material and supplies. The railroad company then made a memorandum entry on its books charging the United States with $286,664.26 on account of such material and supplies. This entry was never considered an account receivable, but stood as a memorandum charge until the final settlement with the Director General in 1920 (R. 58, 112-119).

Taxpayer neither bought nor sold any material or supplies during the Federal control period. When the property was turned back to taxpayer at midnight of February 29, 1920, under the provisions of the Transportation Act of 1920, the Director General of Railroads delivered over to taxpayer an inventory of material and supplies which had cost him $275,912.03, which was carried at that figure on his

books. This amount was entered on the taxpayer's books on March 1, 1920, as the value of material and supplies received from the Director General and the memorandum charge to the United States of $286,664.26 for material and supplies, made January 1, 1918, remained (R. 58, 112-119).

Negotiations were soon entered into looking to a settlement between taxpayer and the Director General, and on or about September 20, 1920, a final settlement was effected in which the Director General allowed taxpayer the sum of $61,314.18 *in respect of its claim for shortage in material and supplies* returned to it over the quantity which it parted with on January 1, 1918 (R. 58, 112).

The Commissioner computed a profit of $50,561.95 to taxpayer on this transaction, which amount he included in taxpayer's 1920 income—this alleged profit being computed as follows:

Inventory of material and supplies turned over by Director General to taxpayer	$275,912.03
Amount allowed taxpayer in final settlement on inventory and supplies	61,314.18
	$337,226.21
Inventory of material and supplies taken over by the President, January 1, 1918	286,664.26
Difference	$50,561.95

The Board of Tax Appeals and the Court of Appeals approved the Commissioner's determination (R. 58, 82-4, 133).

The material and supplies which the Director General returned to taxpayer were inferior in quality to that which he received (R. 120-122), as well as being less in quantity, but the settlement of September 20, 1920, comprehended an allowance of $61,314.18 *only for actual shortage* (R. 113). Taxpayer received nothing whatever in consideration of the inferior quality of the material and supplies received back from the Director General.

The question presented is: Did taxpayer, in view of the

facts stated, realize taxable income in 1920 in the amount of $50,561.95?

The applicable parts of the Federal Control Act of March 21, 1918, are set out above. The pertinent provisions therein are:

> 1. That the railroads should be paid just compensation for the use of their property (Sec. 1, first paragraph).
> 2. That any excess in railway operating income over the just compensation should remain the property of the United States (Sec. 1, second paragraph).
> 3. That *the property* of each carrier should "be returned to it in substantially as good repair and in substantially as complete equipment as it was in at the beginning of Federal control * * *" (Sec. 1, third paragraph set out above).

Obviously the Government did not intend to pay the owners more than "just compensation" for the use of their property. It did not contemplate returning *the property* and at the same time paying a profit on it, after paying just compensation.

The question of just compensation is not involved here—the Government having discharged its obligation for such. The Director General had no authority to pay more and no authority to pay for property which he returned to the carrier. It must be assumed that he acted within his authority in the instant case, because the Commissioner makes no contention to the contrary.

The question then resolves itself into this: Did taxpayer realize a profit upon an allowance of $61,314.18 made by the Director General in the final settlement, which allowance was necessary in order to make taxpayer whole—to return *the property*?

If the Director General had returned material and supplies in quantity and quality equal to that received by the President on January 1, 1918, of course no allowance would have been necessary. Having failed to do this it was up to

him to make taxpayer whole as provided by the statute set out above.

The Director General failed to make taxpayer whole as to quality, but he did *as to quantity* by the payment of the $61,314.18. The record shows that in the final settlement taxpayer and the Director General matched the quantities of material and supplies taken over against the quantities returned back, and after balancing the overages of one kind against the shortages of another, it would have required $61,314.18 to purchase the excess of the shortages over the overages, and the Director General allowed this amount to taxpayer in the settlement. In other words, it required a payment of $61,314.18 to make taxpayer whole—to put it in the same position as it was January 1, 1918, as to the quantity of material and supplies on hand. This does not take into consideration the fact that the material and supplies returned were of an inferior quality, much of which could not be used by taxpayer at all.

In the face of these uncontradicted facts, the Commissioner claims that taxpayer realized a profit of $50,561.95. Yet to sustain this contention would be to hold that the Director General performed an illegal act—that he paid taxpayer a profit (after paying just compensation) which is not authorized by the law.

The Commissioner obviously confused the increase in market value of materials and supplies from January 1, 1918, to February 29, 1920 (or to September 20, 1920) along with corresponding increases in value of all other property with the realization of taxable profit. If taxpayer had an engine worth $25,000.00 when taken over by the Government on January 1, 1918, and that same engine was worth $35,000.00 when returned, there would be no taxable profit to taxpayer. A profit is realized only upon sale or other disposition of property, yet in the Commissioner's theory, taxpayer would have realized a profit of $10,000.00.

It must be remembered that taxpayer was not buying and selling (as merchandise) the various items entering into its so-called inventory of material and supplies. It was only

buying and carrying on hand a stock for its own use. The fluctuation in the amount in dollars and cents between the beginning and end of the year did not constitute a profit and loss item as in a mercantile business where the "inventory" is the stock in trade. Taxpayer's inventory of material and supplies was as much a capital asset as its engines, cars, and track. All of it was property which the Government took over and all of it was property which the Government was bound under the law to return in substantially as good repair and in substantially as complete equipment as it was in at the beginning of Federal control.

The excess of the value of the inventory on February 29, 1920 (or September 20, 1920), over the value on January 1, 1918, was merely an appreciation in value of the same inventory items or their equivalent, which took place at a time when taxpayer was not in possession of the inventory and consequently not in a position to dispose of it or to realize a profit upon it. *Mere appreciation in value of property does not give rise to taxable income.* Before there can be taxable income, the owner must dispose of the property at a price in excess of his cost. Between January 1, 1918, and February 29, 1920, taxpayer could not dispose of any of its property. The receiving back of it on February 29, 1920, or the equivalent, is the direct converse of disposing of it (*Indiana Harbor Belt Railroad Co.*, 16 B. T. A. 279). How, then, could taxpayer realize a profit? And especially when the Director General was not authorized to pay a profit?

If the Court should hold that the allowance of $61,314.18, paid in order to make good the inventory of January 1, 1918, was equivalent to the sale or disposal of part of said inventory and that it would give rise to taxable income to the extent of the profit therein, then that profit would not be $50,561.95. The only profit which could reasonably be computed on such a holding would be arrived at as follows:

Total cost of inventory of January 1, 1918.....		$286,664.26
Cost of inventory February 29, 1920	$275,912.03	
Allowance necessary to make taxpayer whole	61,314.18	
Total value February 29, 1920.....	$337,226.21	337,226.21
Difference which the Commissioner calls profit..		$50,561.95

$$\frac{50{,}561.95}{337{,}226.21} = .15 \text{ or } 15\%.$$

In other words, every dollar of the $337,226.21 would represent 15 cents profit and 85 cents return of January 1, 1918, cost. Therefore the correct profit, in case the Court should hold that there was any profit, would be, not $50,561.95, but 15% of $61,314.18, or $9,197.13. This amount of $9,197.13 is the most profit that could have been realized by taxpayer on any theory.

Put it another way. The $286,664.26 inventory increased in value between January 1, 1918, and February 29, 1920, to $337,226.21. The quantity which the Director General failed to return, worth $52,117.05 on January 1, 1918, would reasonably have increased in the same ratio. So the Director General paid taxpayer $61,314.18 for this shortage, or a profit thereon of $9,197.13.

In *Lehigh & Hudson River Ry. Co.* v *Commissioner* (2d C. C. A.), 36 Fed. (2d) 721, the same issue was involved as is involved here, but the facts differed. That case was decided on the assumption that the *identical quantity* of material and supplies that was taken over from the carrier on January 1, 1918, was returned to it on March 1, 1920, and that, therefore, the amount of money and property paid to the carrier in excess of its cost was profit computed as follows:

Material and supplies returned 3/1/20	$223,000.00
Cash payment allowed	234,800.00
Total	$457,800.00
Material and supplies taken January 1, 1918	336,000.00
Profit realized	$121,800.00

In approving the decision of the Commissioner and the Board of Tax Appeals, that Court said:

> "(4) A question of fact alone remains. The Commissioner assumed in his calculation that the supplies turned over on March 1, 1920, which had cost $223,000, were equal in quantity to supplies on hand on January 1, 1918, which had cost the same amount. It was by subtracting this sum from the cost of the supplies on hand on January 1, 1918, that he found the cost of the supplies used and not replaced ($113,000), the figure which he subtracted from the allowance ($234,000). Obviously the assumption may or may not have been true; probably it was not, because the cost of such supplies was rising and he must have bought a large part of them during his operation of the road. Suppose for instance that all the supplies were coal whose cost was $4 a ton on January 1, 1918, and an average of $5 between then and March 1, 1920. If the Director General had burnt all the original coal, and the cost of what he turned over on March 1, 1920, was $223,000, that would have amounted to 44,600 tons, and the shortage was 39,400 tons, instead of 28,250. In such case the petitioner's profit was $77,200, instead of $121,800.
>
> The board dealt with this question under the burden of proof, correctly as we think. *It was easy for the railway to prove the shortage in the supplies in kind, without leaving the matter to presumption. It was easy, also, to prove what part of the cost of $336,000 this shortage represented.* Having failed to make such proof, the board could do nothing but assume a dollar for dollar equivalency and fix its profit accordingly." (Italics supplied.)

Thus on the facts in that case, or rather the failure of the

carrier to prove the facts under its burden of proof, the Board and the Circuit Court approved the Commissioner's determination of profit. That this was true is perfectly obvious from the language of the Board in its decision in *Indiana Harbor Belt Railroad Co.*, 16 B. T. A. 279.

In the instant case, however, taxpayer has proven that *the quantity of material and supplies returned was less than the quantity taken over* and that the payment of $61,314.18 was *for this shortage* (R. 113-114). It remains then only to determine how much of this payment represented cost to taxpayer of the shortage and how much was profit. That determination is set out above. The *Lehigh & Hudson River Ry. Co.* case therefore supports taxpayer's contention here made.

In *Los Angeles & Salt Lake Railroad Co.*, 18 B. T. A. 168, the Board of Tax Appeals followed the *Lehigh & Hudson River Ry. Co.* case (*supra*) because in that case also the petitioner had failed to prove "shortage" or "overage" as provided for under its contract with the Director General.

It is, therefore, submitted that taxpayer did not realize a taxable profit of $50,561.95 on material and supplies in the final settlement with the Director General.

2. The Court of Appeals, District of Columbia, erred in holding with the Commissioner and the Board, that the deductions of $4,585.32 taken by the Meridian & Memphis Railway Company in each of the years 1924, 1925, and 1926 in amortizing its bond discount, were not allowable deductions in computing consolidated net income for those years.

During 1913 to 1916, inclusive, the Meridian & Memphis Railway Company sold its 30-year bonds of a face value of $675,000.00 at a discount of approximately $131,000.00. Under Interstate Commerce Commission rules it was not permitted to write off this discount in those years, as the bonds were sold, but was required to set it up on its books

and amortize the amount thereof over the life of the bonds. The amount of such amortization charged off each year after 1916 was $4,585.32 (R. 61, 119-120).

A short time after said bonds were issued taxpayer acquired all the stock of the Meridian & Memphis Railway Company, from which date the two companies have been affiliated for income tax purposes. At the end of the Federal control period taxpayer acquired the outstanding bonds of the Meridian & Memphis Railway Company from the War Finance Corporation, which had acquired them during the Federal control period from the original purchaser thereof. Since that time the Meridian & Memphis Railway Company has paid the interest on said bonds to taxpayer. Likewise the Meridian & Memphis Railway Company continued to write off each year the sum of $4,585.32 as amortization of the discount at which it sold the bonds (R. 61, 119-120).

In computing consolidated net income of taxpayer and the Meridian & Memphis Railway Company for each of the years 1924, 1925, and 1926 the Commissioner disallowed as a deduction the aforesaid amount of $4,585.32 on authority of the decision of the Board of Tax Appeals in *New Orleans, Texas and Mexico Railroad Company,* 6 B. T. A. 436, and the Board likewise followed its former decision, when the instant case came before it, and affirmed the Commissioner's action (R. 38, item j, and 88). The Court affirmed the Board's action (R. 133-4.)

During the years 1924, 1925, and 1926, taxpayer owned the bonds in question and the Meridian & Memphis Railway Company paid to it the interest as it accrued thereon. This interest payment was clearly an inter-company transaction which would not affect consolidated income. On the individual basis, however, the Meridian & Memphis Railway Company would be allowed the deduction from income, because it paid the interest, and taxpayer would be compelled to include the amount in its income because it received it. But when the income of the two companies was

combined into consolidated income, because of affiliation, the one entry off-set the other so that consolidated net income was not affected. The consolidated group had no more and no less than it had before—a splendid illustration of a non-taxable transaction between two affiliated companies. (Art. 636, Reg. 65, and Art. 635, Reg. 69, *supra.*)

But when an item entering into the computation of net income of one member of an affiliated group does not appear conversely in the income of another member it is *not* an inter-company transaction and is *not* eliminated from the consolidated net income.

Such an item was the bond discount item which the Meridian & Memphis Railway Company deducted each year in the amount of $4,585.32. This was not income to taxpayer. Taxpayer did not receive anything. Not only were the net assets of the Meridian & Memphis Railway Company reduced each year by the amount of the deduction, but likewise the *total net assets of both companies together was that much less each year.* Therefore, *it was not an inter-company transaction* and should be allowed as a deduction in consolidated net income just the same as any other deduction of the Meridian & Memphis Railway Company which was not income to the taxpayer. (Art. 636, Reg. 65; and Art. 635, Reg. 69, *supra.*)

It must be remembered that the writing off of the bond discount by the Meridian & Memphis Railway Company was the amortizing of a deferred charge which it incurred through sale of its bonds before taxpayer owned either its stock or bonds. It is the regularly recognized and authorized method of taking care of bond discount when corporations are on the accrual basis, as in this case, and is in conformity with Treasury Department regulations. See Art. 545 of Treasury Regulations No. 65 and 69, *supra.* Taxpayer will realize 100 cents on the dollar at maturity for the bonds of the Meridian & Memphis Railway Company which it holds, so that the writing off of this loss by the Meridian & Memphis Railway Company in no way affects

it. Since the Meridian & Memphis Railway Company could not write off the total discount as the bonds were sold, to deny it the right to amortize the amount over the period is to deny it the loss altogether.

It is not believed that the Commissioner would have disallowed the deductions in question but for the Board's decision in the *New Orleans, Texas & Mexico Railroad Company* case (*supra*). It is therefore pertinent to examine the Board's decision and the facts in that case.

An examination of that case discloses the fact that the Board did disallow a deduction for bond discount incurred under circumstances almost identical with those in the instant case. But the Board did not discuss the issue and rested its decision on the case of *Gould Coupler Co.*, 5 B. T. A. 499. *The latter case decided another issue altogether* and furnishes no authority whatever for the position taken by the Board in *New Orleans, Texas, and Mexico Railroad Company* case.

Consideration of the *Gould Coupler* case, however, is very enlightening in connection with the instant question. There the Board discussed at length the nature of consolidated income in the light of the legislative history of the provision. It sets forth the view that Congress intended consolidated income to be the income of the affiliated group as one economic unit. In the light of this discussion, it appears that taxpayer's contention in the instant case is sound, because, if the Meridian & Memphis Railway Company and it are considered as one economic unit, the unit would still be entitled to the deduction claimed (Sec. 240; Art. 636, Reg. 65; and Art. 635, Reg. 69, *supra*).

The deferred charge for bond discount on the subsidiary's books was an asset just the same as prepaid rent is an asset—just the same as a building is an asset. The loss of any of such assets is an allowable deduction in a consolidated return unless the asset passes to the other affiliate.

This position is supported by the following decisions:

Alpha Portland Cement Co. v. *U. S.* (Ct. Cls.), 44 Fed. (2d) 92;
Hernandez v. *Charles Ilfeld Co.* (10 C. C. A.), 66 Fed. (2d) 236.

In the *Alpha Portland Cement Company* case, the Court of Claims held that where the Alpha Company held all the stock of the Catskill Company and the latter disposed of an asset at a loss—even though it had borrowed the money from the Alpha Company with which to acquire the asset—the loss was deductible in the consolidated return of the two companies for that year.

In the *Hernandez* case, the Circuit Court of Appeals, Tenth Circuit, held that the true income of the affiliated group would be distorted if the separate income and loss of a member of the group is not recognized in the consolidated return.

Finally this Court in *Burnet* v. *Aluminum Goods Mfg. Co.*, 287 U. S. 544, 53 S. Ct. 227, enunciated the same principle when it said, with reference to a loss sustained by one member of an affiliated group of corporations disallowed by the Commissioner on the ground that it was an intercompany loss:

> "The loss was a real one, suffered by respondent as a separate corporate entity, and it was equally a loss suffered by the single business carried on by the two corporations during the period of their affiliation, * * *."

It should be remembered that, in the instant case, we are not dealing with the bonds themselves. The Meridian & Memphis Ry. Co. still owes the face of the bonds which must be paid in full at maturity. There is nothing to prevent taxpayer from selling those bonds at any time, but, regardless of who owns the bonds, the bond discount in question is a deferred charge—an asset—of the subsidiary and the charging off of a part each year is a "*real* loss, suffered by it as a separate entity," and it is also "a loss

suffered by the single business carried on by the two corporations." The net assets of the subsidiary are reduced by the amount charged off each year and, likewise, the net assets of the consolidated group are reduced by a like amount.

It is therefore submitted that the Court of Appeals erred in denying the bond discount deductions and that this Court should grant certiorari on this question.

CONCLUSION.

Wherefore, it is submitted that the petition for certiorari should be granted.

Respectfully submitted,

GEO. E. H. GOODNER,
Attorney for Petitioner,
Address: Munsey Building,
Washington, D. C.

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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 413

GULF, MOBILE & NORTHERN RAILROAD CO., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE RESPONDENT [redacted]

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 51) is reported in 22 B. T. A. 233. The opinion of the Court of Appeals (R. 128) is reported in 71 F. (2d) 953.

JURISDICTION

The judgment of the Court of Appeals was entered on May 14, 1934 (R. 135), and was modified on June 25, 1934 (R. 135–136). The petition for

certiorari was filed on September 25, 1934. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Where the Government took over the railroad of the taxpayer under the Federal Control Act and at the end of Federal control returned the property to the taxpayer, whether the taxpayer realized taxable income in the amount of $50,561.95 as the result of the Director General allowing its claim on account of a shortage of materials and supplies, within the meaning of Article 49 of Treasury Regulations 45.

2. Where several corporations file a consolidated return and the bonds of one of the subsidiaries, which were originally issued at a discount, are held during the taxable year by the parent company, whether the amortization and deduction of bond discount by the subsidiary is an intercompany transaction during the taxable years under Articles 636 and 635 of Treasury Regulations 65 and 69, respectively, and should be eliminated.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 10–12.

STATEMENT

The facts as found by the Board of Tax Appeals and relating to the issues involved in this petition (R. 56, 58, 61) may be summarized as follows:

The properties of the Gulf, Mobile & Northern were taken over by the President and were operated by the Director General of Railroads throughout the period January 1, 1918, to February 29, 1920. Among the assets and properties taken over by the Director General was an inventory of materials and supplies which had cost the taxpayer $286,664.26. At the conclusion of Federal control the Director General turned back to the taxpayer an inventory of materials and supplies of the market value of $275,912.03. The inventory so turned back included a greater quantity of some materials and a lesser quantity of other materials than were included in the inventory taken over by that official. Much of the materials in the inventory turned back by the Director General was, as to quality and relative usefulness, inferior to the material turned over to that official at the beginning of Federal control. (R. 58.)

In 1920 the Gulf, Mobile & Northern and the Director General effected a final settlement of all claims arising out of Federal control and operation of the former's properties, as a result of which the taxpayer paid to the Director General the sum of $100,000. One of the claims asserted by the taxpayer, and allowed by the Director General, was

for shortages in, and differences in grade and quality of, materials and supplies turned back by the Director General, in comparison with the materials and supplies turned over to that official at the beginning of Federal control, and amounted to $61,314.18. Thus the taxpayer received from the Director General, in 1920, cash and materials and supplies of an aggregate value of $337,226.21, which exceeded the cost of the inventory turned over to the Director General by $50,561.95. The Commissioner held that such excess is income for 1920, and accordingly added $50,561.95 to income for that year. (R. 58.) The Board of Tax Appeals decided that there was a completed transaction in 1920, and, in the absence of evidence as to the actual gain, upheld the Commissioner's determination that the gain was $50,561.95. (R. 84.) The Court of Appeals affirmed the decision of the Board on this point. (R. 133.)

At various dates between 1913 and 1916 the Meridian & Memphis sold its 30-year 5-percent gold bonds, of a total face value of $675,000, to the Equitable Loan & Mortgage Company of Mobile, at a discount of approximately $131,000. At the time the Gulf, Mobile & Northern acquired the capital stock of the Meridian & Memphis, the bonds of the latter were pledged as collateral for certain collateral trust notes of the Equitable Loan & Mortgage Company. These notes fell due during the period of Federal control and were taken up by the

War Finance Corporation. At the end of Federal control the Gulf, Mobile & Northern settled with the War Finance Corporation for the notes and took over the bonds pledged as collateral thereto at a cost of $636,000. Each year the Meridian & Memphis has charged off on its books 1/30th of the discount on its bonds, and in its returns for 1924, 1925, and 1926 claimed deductions for amortization of bond discount, each in the amount of $4,585.32. These deductions were disallowed by the Commissioner in determining consolidated net income. (R. 61.) The Board of Tax Appeals upheld the Commissioner's action (R. 88), and the Court of Appeals affirmed the decision of the Board on that point (R. 134).

ARGUMENT

In regard to the question whether the taxpayer realized taxable income as the result of the inventory adjustment in the final settlement with the Director General, Article 49 of Treasury Regulations 45 (1920 ed.), *infra*, p. 11, provides that where the owner of property has transferred title by reason of the exercise of the power of eminent domain, and has received compensation in excess of the cost, the transaction will be deemed to be completed, unless the taxpayer elects to replace or restore the property. In other words, the regulations treat a transaction under such circumstances as analogous to a sale, so that the excess over cost is subject to tax. This provision has been included in every

series of Treasury Regulations from 1918 until 1933.[1] Section 213 of the Revenue Act of 1918, in explanation of which Article 49 of Treasury Regulations 45 was promulgated, was reenacted without material change in the Revenue Act of 1921. The reenactment of the statutory provision without material change must be deemed to constitute legislative approval of the administrative construction. *Brewster* v. *Gage,* 280 U. S. 327, 337; *Burnet* v. *Brooks* 288 U. S. 378, 392–393.

As a matter of fact, the provision of the regulations was expressly written into the Revenue Acts of 1924, 1926, 1928, and 1932. See Section 203 (b) (5) of the Revenue Acts of 1924 and 1926, and Section 112 (f) of the Revenue Acts of 1928 and 1932.

The Circuit Court of Appeals for the Second Circuit upheld the regulations in question in *Lehigh & Hudson River Ry. Co.* v. *Commissioner,* 36 F. (2d) 719, certiorari denied, 281 U. S. 748. In that case, which involved similar circumstances, the court said (p. 720):

> Such a transaction is equivalent for tax purposes to a sale of the supplies at the agreed price. The act of 1918 (40 Stat. 1057) did not, indeed, expressly provide for gains arising from the requisition of property, but article 49 of the Regulations did:

[1] Treasury Regulations 62, Article 49; Treasury Regulations 65, Article 1579; Treasury Regulations 69, Article 1579; Treasury Regulations 74, Article 579; Treasury Regulations 77, Article 579.

> "When the owner of property has lost or transferred title by reason of requisition or eminent domain * * * if the taxpayer does not elect to replace or restore the property, the transaction will then be deemed to be completed and the income shall be measured by the excess of the amount of the compensation over the cost of the property." This article and article 50 prescribed the formalities by which the election should be manifested, with none of which the railway conformed.

The taxpayer contends that the decision of the lower court is in conflict with the principle laid down in the *Lehigh & Hudson River Ry.* case. (Br. 4–5.) On the contrary, both the lower court and the Board of Tax Appeals cited that decision with approval. The taxpayer also contends that the question is important in revenue taxation affecting a great many railroads whose tax cases have not yet been settled. (Br. 5.) We have been advised by the Treasury Department that the question of inventory adjustment of materials and supplies is involved in very few, if [redacted], cases that are still open. The taxpayer also argues that if there was any gain on the inventory adjustment of materials and supplies it should have been $9,000 instead of $50,000. (Br. 16.) If the taxpayer had conformed to the provisions of Article 50 of Treasury Regulations 45, it might have reduced the gain for the year 1920. In such a case, however, the taxpayer's

income for the years following 1920 when these materials and supplies were used would have been increased in the amount of the balance, or $41,000, by having the deduction for business expenses decreased in a corresponding amount. Since those years are no longer open, the taxpayer is estopped to say that the profit in the year 1920 should be limited in such a manner.

With respect to the right of the taxpayer to amortize and deduct the discount on bonds issued by an affiliated company but now held by the taxpayer, this Court granted certiorari upon the same question in *Old Mission Portland Cement Co.* v. *Helvering,* No. 107, October Term, 1934. Under the circumstances we do not oppose the granting of the writ on this question.

CONCLUSION

The decision of the court below on the question of realizing income upon the allowance of taxpayer's claim based upon a shortage of materials and supplies seems to be correct, and there is no conflict of decisions. Moreover, the question is not of general importance.

As to the question of the right of the taxpayer to deduct the amortized discount on bonds issued by an affiliated company, we do not oppose the granting of the writ in view of this Court's action in granting certiorari upon the same question in an-

other case. Therefore, the petition should be granted, limited to this question.

Respectfully submitted.

J. CRAWFORD BIGGS,
Solicitor General.

FRANK J. WIDEMAN,
Assistant Attorney General.

JAMES W. MORRIS,
MORTON K. ROTHSCHILD,
Special Assistants to the Attorney General.

OCTOBER 1934.

APPENDIX

Statutes and Regulations Involved

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065:

> Sec. 213. That for the purposes of this title * * * the term "gross income"—
>
> (a) Includes gains, profits, and income derived from * * * any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period;
>
> * * * * *

Federal Control Act of March 21, 1918, c. 25, 40 Stat. 451:

> Sec. 1. That the President, having in time of war taken over the possession, use, control, and operation (called herein Federal control) of certain railroads and systems of transportation (called herein carriers), is hereby authorized to agree with and to guarantee to any such carrier making operating returns to the Interstate Commerce Commission, that during the period of such Federal control it shall receive as just compensation an annual sum, * * *.
>
> * * * * *
>
> Every such agreement shall also contain adequate and appropriate provisions for

the maintenance, repair, renewals, and depreciation of the property, for the creation of any reserves or reserve funds found necessary in connection therewith, and for such accounting and adjustments of charges and payments, both during and at the end of Federal control as may be requisite in order that the property of each carrier may be returned to it in substantially as good repair and in substantially as complete equipment as it was in at the beginning of Federal control, and also that the United States may, by deductions from the just compensations or by other proper means and charges, be reimbursed for the cost of any additions, repairs, renewals, and betterments to such property not justly chargeable to the United States; in making such accounting and adjustments, due consideration shall be given to the amounts expended or reserved by each carrier for maintenance, repairs, renewals, and depreciation during the three years ended June thirtieth, nineteen hundred and seventeen, to the condition of the property at the beginning and at the end of Federal control and to any other pertinent facts and circumstances. * * *

Transportation Act, 1920, c. 91, 41 Stat. 456, 459:

SEC. 202. The President shall, as soon as practicable after the termination of Federal control, adjust, settle, liquidate, and wind up all matters, including compensation, and all questions and disputes of whatsoever nature, arising out of or incident to Federal control.

Treasury Regulations 45 (1920 ed.), relating to the Revenue Act of 1918:

ART. 49. *Compensation for loss.*—* * * where the owner of property has lost or transferred title by reason of the exercise of

> the power of requisition or eminent domain, * * * the amount received by the owner as compensation for the property may show an excess * * * over its cost, * * *. The transaction is not regarded as completed at this stage, however, if the taxpayer proceeds immediately in good faith to replace the property, or if he makes application to establish a replacement fund as provided in the following article. * * * If the taxpayer does not elect to replace or restore the property, the transaction will then be deemed to be completed and the income shall be measured by the excess of the amount of the compensation received over the cost of the property. * * *

Treasury Regulations 65 relating to the Revenue Act of 1924:

> ART. 545. *Sale and retirement of corporate bonds.*—* * *
>
> (3) (*a*) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. * * *
>
> ART. 636. *Consolidated net income of affiliated corporations.*—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated. * * *

Articles 545 and 635 of Treasury Regulations 69 relating to the Revenue Act of 1926 contain the same provisions.

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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 413

GULF, MOBILE & NORTHERN RAILROAD CO.,
petitioner

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 66–95) is reported in 22 B. T. A. 233. The opinion of the United States Court of Appeals for the District of Columbia (R. 128–134 is reported in 71 F. (2d) 953.

JURISDICTION

The judgment of the United States Court of Appeals for the District of Columbia was entered May 14, 1934 (R. 135). Its modified judgment was en-

tered June 25, 1934 (R. 135–136). Petition for writ of certiorari was filed September 20, 1934. Certiorari was granted November 5, 1934, limited to the sole question of the right of the taxpayer to deductions on account of amortization of bond discount. Jurisdiction is conferred on this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the amortization of the discount on bonds issued by a corporation, one of an affiliated group, and owned by a member of the same group, should be deducted in computing the consolidated net income of the affiliated companies for the years 1924–1926, inclusive.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved appear in the appendix to respondent's brief in *Old Mission Portland Cement Co.* v. *Helvering,* No. 107, with which the instant case is set for hearing.

STATEMENT

The facts found by the Board of Tax Appeals pertinent to the above issue may be summarized as follows: During the years 1924 to 1926, inclusive, the Gulf, Mobile & Northern and the Meridian & Memphis were affiliated, and for each of these years these corporations filed consolidated income-tax returns (R. 56, 88).

At various times between the years 1913 and 1916 the Meridian & Memphis sold its thirty-year 5% gold bonds, of a total face value of $675,000, to the Equitable Loan & Mortgage Company of Mobile, at a discount of approximately $131,000. At the time the Gulf, Mobile & Northern acquired the capital stock of the Meridian & Memphis the bonds of the latter were pledged as collateral for certain collateral-trust notes of the Equitable Loan & Mortgage Company. These notes fell due during the period of Federal control and were taken up by the War Finance Corporation. At the end of Federal control the Gulf, Mobile & Northern settled with the War Finance Corporation and took over the bonds pledged as collateral, at a cost of $636,000. Each year the Meridian & Memphis has charged off on its books one-thirtieth of the discount on the bonds, and in its returns for each of the years 1924, 1925, and 1926 claimed deductions for amortization of bond discount, each in the amount of $4,585.32 (R. 61).

The Commissioner disallowed these deductions. The Board of Tax Appeals upheld the Commissioner's determination, and the court below sustained the Board.

MEMORANDUM

The question presented is identical with "Question 1" in the case of *Old Mission Portland Cement Co.* v. *Helvering,* No. 107, with which the instant

case has been set for hearing. In both cases the attorney for the taxpayer is the same.

Outside of the fact that the bonds in the instant case were issued subsequent to March 1, 1913, there are no material differences in the facts of the two cases. Therefore, respondent refers to and relies upon his brief filed in No. 107, concluding that the decisions below should be affirmed.

Respectfully submitted.

FRANK J. WIDEMAN,
Assistant Attorney General.
ROBERT N. ANDERSON,
SEWALL KEY,
A. F. PRESCOTT,
Special Assistants to the Attorney General.

NOVEMBER 1934.

U. S. GOVERNMENT PRINTING OFFICE: 1934

SUPREME COURT OF THE UNITED STATES.

No. 413.—October Term, 1934.

Gulf, Mobile & Northern Railroad Company, Petitioner, *vs.* Guy T. Helvering, as Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Court of Appeals for the District of Columbia.

[December 3, 1934.]

Mr. Justice Stone delivered the opinion of the Court.

Certiorari was granted in this case "limited to the question of the right of the taxpayer to deductions on account of amortization of bond discount." 293 U. S. —. At various dates between 1913 and 1916, Meridian & Memphis Railway Company sold its thirty year 5% gold bonds at a discount. During the years 1924 to 1926, inclusive, while petitioner was the owner and holder of the entire bond issue, it joined with the Meridian & Memphis in filing consolidated income tax returns as affiliated corporations. In each year the latter deducted from gross income the amortized bond discount. The deductions were disallowed by the Commissioner. His action was sustained by the Board of Tax Appeals, 22 B. T. A. 233, and by the Court of Appeals for the District of Columbia. 71 F. (2d) 953. The question presented is the same as that decided this day in No. 107, *Old Mission Portland Cement Company v. Helvering*. The judgment of the court below was therefore right and is

Affirmed.

Mr. Justice Butler and Mr. Justice Roberts think the judgment should be reversed.